

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
BRIEF**

ORIGINAL

74-1157

United States Court of Appeals

FOR THE SECOND CIRCUIT

WILLIAM R. VAN GEMERT, *et al.*,

Plaintiffs-Appellants,

against

THE BOEING COMPANY,

Defendant-Respondent.

On Appeal from the United States District Court
for the Southern District of New York.

BRIEF FOR PLAINTIFFS-APPELLANTS

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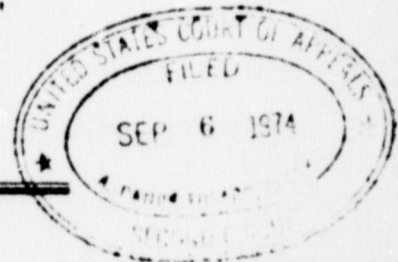
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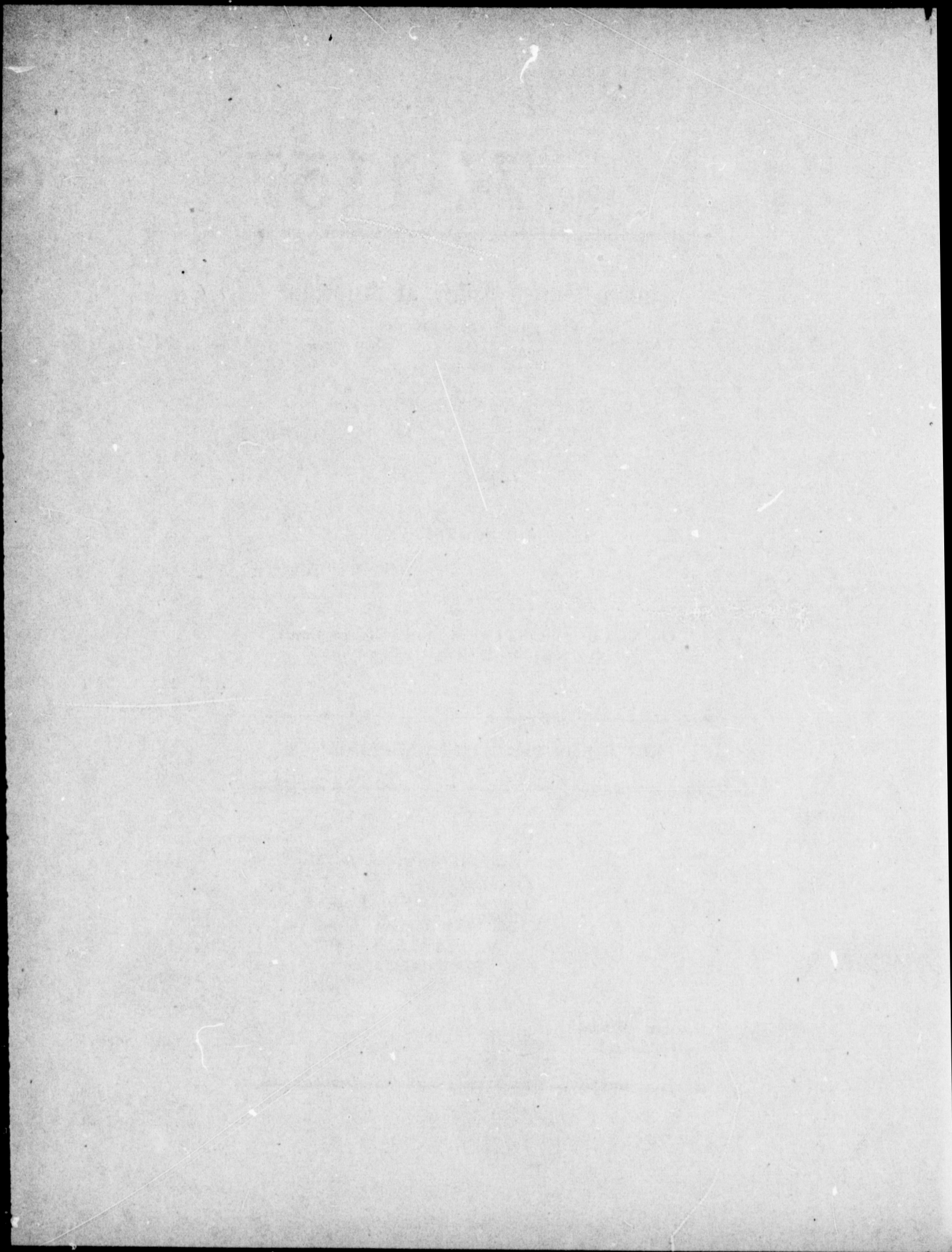


TABLE OF CONTENTS

	Page
<u>The Issues Presented for Review</u>	1
<u>Statement of the Case</u>	
i. Nature of the Case	2
2. The Course of Proceedings	2
<u>The Facts</u>	
A. Generally	3
B. The Background	
1. Issuance of the Debentures	3
2. The Purchasers of the Debentures	5
3. The Form of the Debentures	5
4. The Conversion Rate Provisions	6
5. The Call Provisions of the Indenture	8
C. The Events Which Affected the Conversion Rate	
1. The Shares Issued	9
2. The 1958 Stock Dividend	9
3. The 1959 Stock Dividend	12
4. The Vertol Transaction	13
(a) The Obvious Necessity to Change the Rate	13
(b) The November 13, 1959 Meeting	15
(c) The Continuing Vertol Negotiations	17

	<u>Page</u>
5. Revision of the Calculations of the Stock Dividends	18
6. The Conditions Included in the Vertol Contract	20
7. The Closing	21
8. Valuing the Consideration Received for the Shares Issued and for the Options Granted for Vertol	22
(a) Who Did the Valuing- the Conflict of Interest	22
(b) The Board Meeting at Which the Value was Determined	23
(c) Mr. Haynes' Computations of the Consideration Received for Shares Issued to Vertol and Options Granted	29
(d) Boeing's Efforts to Find a Satis- factory Calculation	31
(e) The Miscalculations Were Consistent with Boeing's "Basic Objective"	32
(f) The Testimony on the November 13, 1959 date	34
(g) The Computations Under the Various Possibilities Urged	35

TABLE I

TABLE II

D. The Notice of Call for Redemption of the Debentures	36
1. The Decision to Call	36
2. The "Notice" Given	37
3. Boeing's Proof of Other Publication	38
4. A Letter to Stockholders	38

	<u>Page</u>
5. A Letter to those Who Exercised the Warrants	39
6. A Letter to those who Collected January 1, 1966 Coupons	40
7. Notice Could Have Been Given to those who Deposited July 1, 1966 Coupons	42
<u>Argument</u>	42
<u>POINT I Boeing Has Been in Default Under the Conversion Rate Provisions from March 31, 1960 to Date</u>	42
A. The Several Breaches	42
B. Breach of Section 4.05 (b)(v)	43
C. The November 13, 1959 Date	44
D. The Stock Dividends	47
E. Results in Dollars and in Conversion Rate of Each Boeing Maneuver	50
(a) The November 13, 1959 Date as Against March 31, 1960	50
(b) The November 13, 1959 Date as Against January 18, 1960	51
<u>POINT II The Court Below Erred on the Facts in Finding that Boeing Acted in "Good Faith" and Erred on the Law in Concluding that "Good Faith" Excuses a Breach of Contract</u>	51
A. "Good Faith" As a Fact	51
B. The Significance of "Good Faith" in Breach of Contract	55
<u>POINT III Boeing Could Not Terminate the Conversion Option While Boeing Was in Breach of the Conversion Provisions</u>	58
A. The Breach Was Material	58

	<u>Page</u>
B. The Effect of the Material Breach	59
C. The Option to Register	63
D. The Debenture Was a Contract of Adhesion	64
E. Reasonable Expectations of Notice	67
F. Notice by Publication Is the Least Satisfactory Form of Notice	68
<u>POINT IV Boeing Violated Section 10(b) of the Exchange Act as Well as the Trust Indenture Act</u>	70
A. Section 10(b) and the Conversion Rate	70
B. Section 10(b) and the Failure to Give Notice	71
C. The Trust Indenture Act	72
<u>POINT V By Misstating the Conversion Rate the Call Did Not Conform to the Indenture</u>	73
<u>POINT VI The Holders Are Entitled to Damages for the Value of All of the Shares They Would Have Received Had the Debentures Been Properly Called</u>	74
CONCLUSION	76
Exhibit I Letter to Boeing Stockholders Dated December 17, 1958	
Exhibit II Pages 1 and 4 from Accounting Principles Board Opinion No. 10 December, 1966	

TABLE OF CASES, ARTICLES AND TEXTS

	<u>Page</u>
<u>Affiliated Ute Citizens, etc. v. United States, et al</u> , 406 U.S. 128, 31 L. ed 2d 741 (1972)	70
<u>Allis-Chalmers Mfg. Co. v. Gulf & Western Industries</u> , 372 F.S. 570 (N.D. Ill., 1974)	46
<u>American Service etc. Co. v. Bottum</u> , 371 F. 2d 6 (C.A. 8, 1967)	63
<u>Barrette v. Home Lines Inc.</u> , 168 F.S. 141 (S.D.N.Y. 1958)	63
<u>Berkey v. Pueblo County</u> , 48 Colo. 104, 110 P. 197 (1910)	62
<u>Blau v. Mission Corp.</u> , 212 F. 2d 77, 80 (C.A. 2, 1954)	47
<u>Blau v. Ogsbury</u> , 210 F. 2d 426, 427 (C.A. 2, 1954)	46
<u>Campbell Soup Company v. Wentz</u> , 172 F. 2d 80 (C.A. 3, 1948)	63, 67
<u>C.I.R. v. Ogsbury's Estate</u> , 258 F. 2d 294 (C.A. 2, 1958)	46
"Convertible Securities: Holder who Fails to Convert Before Expiration of the Conversion Period" 54 Cornell L.R. 271	61
<u>DeMilia v. Cybernetics International Corp.</u> , C.C.H. Fed. Sec. Rep. '71-'72 Dec. 793386	75
<u>Eisen v. Carlisle & Jacquelin</u> , 391 F. 2d 555, 569 (C.A. 2, 1968)	69
Fletcher, Cyclopedia of Corporations, Perm. Ed., 1971, Vol. II, p. 745	47
<u>Henningesen v. Bloomfield Motors Inc.</u> , 32 N.J. 358, 161 A. 2d 69 (1960)	67
<u>Hinds County v. National Life Ins. Co.</u> , 104 Miss. 104, 61 So. 164 (1913)	62

	<u>Page</u>
<u>Industrial & General Trust Ltd. v. Tod,</u> 180 N.Y. 215 (1904)	57
<u>Lachs v. Fidelity & Casualty Co.,</u> 306 N.Y. 357 (1954)	66
<u>Lewis v. Realty Equities Corp.,</u> 373 F.S. 829 (S.D.N.Y., 1974)	46, 47
<u>Miller v. Alexander Grant & Co.,</u> C.C.H. Fed. Sec. Rep. '71-'72 Dec. 793287	75
<u>Morris v. Standard Gas & Electric Co.,</u> 31 Del. Ch. 20, 63 A. 2d 577 (1949)	57
<u>Mueller v. Howard Aircraft Corp.,</u> 329 Ill. App. 570, 70 N.E. 2d 203 (1946)	60
<u>Mullane v. Central Hanover etc. Co.,</u> 339 U.S. 306, 315, 94 L. ed. 865 (1950)	68
<u>New York v. New York etc. R. Co.,</u> 344 U.S. 293, 97 L. ed. 333 (1953)	
<u>Osborn v. Boeing Airplane Company,</u> 309 F. 2d 99 (C.A. 9, 1962)	62, 64, 65
Patterson "The Interpretation and Construction of Contracts, 64 Col. L.R. 833, 856 (1964)	64
Restatement of Contracts, Sec. 269	59
<u>Shapiro v. Merrill Lynch et al.,</u> 495 F. 2d 228, 240 (C.A. 2, 1974)	70
<u>Shay v. Agricultural etc. Committee,</u> 299 F. 2d 516 (C.A. 9, 1962)	63, 67
<u>Standard Oil Co. v. Perkins,</u> 347 F. 2d 379 (C.A. 9, 1965)	67
<u>Steven v. Fidelity & Casualty Co.,</u> 58 Cal. 2d 862, 377 P. 2d 284 (1962)	66
<u>Stoner v. United States,</u> 313 F.S. 1383, 1388 (N.D. Ill., 1970)	46

THE ISSUES PRESENTED FOR REVIEW

The principal issues presented for review are:

1.

Was the failure of Boeing to adjust the conversion rate of the convertible debentures a breach of contract?

If it was a breach of contract, had Boeing the right to call the debentures for redemption?

Was the call which announced an erroneous conversion rate a valid call?

2.

Was the indenture a contract of adhesion?

If so, did the two advertisements in the Wall Street Journal constitute a call which satisfied the reasonable expectations of the holders?

Did Boeing violate Section 10(b) of the 1934 Act or the Trust Indenture Act?

1.

STATEMENT OF THE CASE

1. Nature of the Case

This is a representative class action brought by holders of The Boeing Company 4 1/2% Convertible Debentures of July 1, 1980, who tendered their bonds for conversion after March 29, 1966 and whose tender was rejected as late. The stock which they were entitled to receive was, under the New York rule, worth \$378.56 for each \$100 of debenture. Boeing offered the redemption price of \$103.25 for each \$100. The aggregate loss to those who did not convert was \$4,251,612.33 which plaintiffs seek to recover here. Those who did convert before the call date were also damaged in that they were given fewer shares than they were entitled to receive.

2. The Course of Proceedings

Ten actions were filed by plaintiffs in New York, Pennsylvania, Florida, Illinois, California and the District of Columbia. On October 4, 1966, the ten actions were consolidated in the Southern District Court and Judge Sylvester J. Ryan designated himself as Rule 2 Judge.

There followed production of documents, depositions, a stipulation of facts, admissions and several motions. The stipulation of facts consisted of 167 statements covering 52 pages and there were annexed 54 agreed exhibits.

The trial was held on November 15, 16, 17 and 20, 1972. The 31 page opinion is dated November 29, 1973. Two witnesses were fact witnesses only, two were partly fact and partly expert witnesses and one (for plaintiffs) was an accounting expert.

Detailed proposed Findings and Conclusions were submitted

by both sides but were not ruled upon. Judge Ryan's opinion contained his findings and conclusions and gave defendant judgment and costs.

Plaintiffs appeal.

THE FACTS

A. Generally

The essential facts relate to two distinct wrongs inflicted by The Boeing Company on the holders of "Boeing Airplane Company 4 1/2% Convertible Subordinated Debentures due July 1, 1980", referred to hereinafter as "the debentures".

The first wrong occurred between November, 1959 and April, 1960. In that period, Boeing violated those terms of the underlying indenture which required it to increase the conversion rate of the debentures.

The second wrong occurred in 1966. At a time when, even on Boeing's calculation of the conversion rate, the debentures were convertible into stock worth 3 1/2 times the redemption price, Boeing published a ritualistic notice in the Wall Street Journal calling for redemption of the debentures. Boeing claimed that those who did not see the notice lost their rights to convert.

As stated above, if Boeing is successful here the loss to those who did not convert will be \$4,251,612.33; and there will be loss too to those who did convert.

B. The Background

1. Issuance of the Debentures

By letter dated June 25, 1958, Boeing's President, Mr. William M.

Allen informed stockholders of record that Boeing intended shortly to issue debentures in the principal amount of \$30,597,600 and that rights would be issued to the stockholders enabling them to purchase debentures in multiples of \$100 for each 23 shares held (A.E. 5).*

On July 15, 1958, Mr. Allen sent to stockholders 1) a second letter (A.E. 15) 2) a warrant representing one right for each share held (A.E. 14, A.S. 34)* and 3) a 31 page prospectus (A.E. 15).

The warrant was transferable but was exercisable by the transferee only if "the name and address of the new holder executing the subscription [is] filled in on Form 3." (A.E. 14, p. 2, Direction No. 4, underscoring in original). 23 rights plus \$100 bought a debenture in the face amount of \$100.

The heading of the prospectus, after the name, is (A.E. 15, third page):

"Convertible until maturity, unless previously redeemed, into Capital Stock at the conversion rate of 2 shares of Capital Stock for each \$100 principal amount of Debentures (equivalent to a conversion price of \$50 per share), subject to adjustment in certain events."

In the body of the prospectus there are four full pages (pp 17-21) under the heading:

"DESCRIPTION OF THE CONVERTIBLE SUBORDINATED DEBENTURES"

With respect to the two breaches of which we complain, there are three significant omissions from the letter, the warrant and the prospectus:

* A.E. means Agreed Exhibit. A.S. means Agreed Statement of Facts.

1) nowhere is the prospective purchaser informed that he will have the right to exchange his coupon bond for a registered bond;

2) nowhere is he informed that if Boeing elects to call the debentures it may do so by two notices in any English language newspaper of general circulation in Manhattan at any time in the next 22 years (the prospectus does refer to "published notice");

3) it is said (p. 19) that "The indenture contains provisions to protect the conversion rate against dilution by making appropriate adjustments therein" and that "such adjustments will be based on the consideration received for such Capital Stock" but nowhere is it stated that in case of an acquisition for stock the value of such "consideration received" shall be fixed by a Board of Directors with interests adverse to those of the debentureholders.

2. The Purchasers of the Debentures

7,037,447 rights were issued. Total trading in the rights was 1,702,200 so that if we assume that no right was traded more than once, 76% of the rights were never traded (A.S. 41). Since 97% of the debentures were purchased on rights, it is conservative to say that approximately 76% of the debentures were purchased by stockholders (A.S. 46).

3. The Form of the Debentures

The entire issue of \$30,597,600 was issued and delivered in

coupon form after payment therefor (A.S. 46, 48).

The first information to the purchaser that he might return his coupon bond and receive a registered bond in exchange appears in the eighth paragraph of miniscule print on the debenture (A.E. 1).

The only guide to the type of notice required for a call appears in the ninth paragraph of the same fine print; it informs the reader that the call shall be "on not less than 30 nor more than 90 days' prior notice, as provided in the Indenture." There is no reference to notice by publication and no suggestion as to where a copy of the indenture may be found.

Throughout the eight-year life of the issue, a grand total of \$2,175,700 of debentures were registered (A.S. 57, 58). If we assume that none of these involved reregistration by the transferee of a registered debenture, then 93% of the issue was never registered. The probability is that the percentage was still greater.

4. The Conversion Rate Provisions

The basic conversion rate was 2 shares of Boeing stock for each \$100 of debenture (A.E. 4, Section 4.04, p. 33).

The provisions as to when and how the conversion rate was to be changed ("adjusted" is the word used) appear in Section 4.05 at p. 34 et seq. For clarity, we must begin with Section 4.05(b) at p. 35 and then return to Section 4.05(a).

The Indenture assumes that on July 1, 1958 each of Boeing's 7,037,447 outstanding shares was worth \$50 so that the aggregate worth was \$351,872,350 (p. 35). Thus, if Boeing should issue shares thereafter for less than \$50, the worth of each Boeing share would decrease and the value of the right to convert

at \$50 would diminish; therefore, adjustment of the rate would be necessary for the debentureholder to be even.

The first step then was to "determine" the "value" of the "consideration [to be] received" for shares to be issued in the future. At p. 35 the valuation principles insofar as relevant here were:

- (i) if Boeing should issue shares for cash they would be valued at the amount of cash received for them;
- (ii) if Boeing should issue shares for a consideration other than cash, the "value" of the "consideration received" therefor would be determined by Boeing's Board of Directors;
- (iv) if Boeing should issue shares as a "Limited Stock Dividend" (4% or less) the "consideration received" for the "shares so issued" would be "determined" in the manner described in Section 1.01 of the Indenture; and
- (v) if Boeing should grant options to purchase shares for a total consideration of less than \$50, such optioned shares would be treated as issued at the time of the grant of the option and the "consideration received" would be the sum of the price, if any, paid for the option plus the exercise price.

We interject here that Boeing violated not just one of the foregoing subdivisions but three of them, (ii), (iv) and (v).

Having determined the "consideration received" the Indenture

required a return to Section 4.05(a) at p. 34 for the application of a formula to determine the extent and the effect of the dilution.

The formula was this:

"\$100 shall be multiplied by the number of shares of Capital Stock outstanding after any such issuance... and the resulting product shall be divided by the aggregate consideration determined in accordance with subparagraph (b) of this Section 4.05, received by the Company for its shares of Capital Stock then outstanding ... The resulting quotient, adjusted to the nearest one-hundredth, shall thereafter be the conversion rate (until further adjusted) if it is greater than the basic conversion rate as defined in subparagraph (d) of this Section 4.05. If the resulting quotient, adjusted to the nearest one-hundredth, is less than the basic conversion rate, as so defined, the conversion rate shall be the basic conversion rate".

Expressed algebraically the formula was:

$$\frac{\$100 \times \text{the new total of outstanding shares}}{\$351,872,350 \div \text{the consideration received for the new shares}} = \text{the new conversion rate}$$

5. The Call Provisions of the Indenture

Section 5.01 (A.E. 4, p. 40) gave Boeing the option to redeem the debentures at any time at progressively declining prices. Under Section 5.02 (p. 41) this might be done by publishing twice in successive weeks in any English language newspaper published five or more days a week "and of general circulation" in the Borough of Manhattan (Section 1.01, p. 10)

The notice was required to state "the conversion rate at the time applicable" (p. 42).

In the event of a call for redemption the conversion option would terminate "after the close of business on the tenth day prior to the date fixed for such redemption" (Section 4.01, p. 31).

C. The Events which Affected the Conversion Rate

1. The Shares Issued

Between November, 1959 and April, 1960, Boeing issued 878,980 shares and granted options to purchase 23,782 shares, thereby increasing the number of shares outstanding by nearly 13%. Approximately 70% of these shares were issued for a "consideration" far below \$50. Boeing, at no time, adjusted the conversion rate.

Boeing's position is that it was not required to adjust until the rate exceeded 2.044999 (See A.E. 28, "(1) lowest Value without Change"). It claims that the rate reached a "top" of 2.0448 and thus missed the requirement of adjustment by .0002 (A.S. 92).

Our claim is that the nearest one-hundredth was 2.08 and we interject again that this difference of .08 of a share for each \$100 involved millions of dollars.

2. The 1958 Stock Dividend

On November 4, 1958, Boeing declared a 4% stock dividend for which it issued 281,537 shares (A.S. 63)*. Needless to say, a corporation receives no consideration whatever in exchange for a stock dividend but since the Indenture creates a fictitious "consideration" for such a dividend, we have accepted the terms of the Indenture.

On December 31, 1958, Boeing calculated the effect of the stock dividend on the conversion rate. The following is a

* The stipulation gives the date as November 3, 1958, but the parties have agreed that that was an error.

typed reproduction of A.E. 19 which is a photocopy of the original calculation:

Boeing Airplane Company

Conversion Rate
12/31/58

	<u>Shares Outstanding</u>	<u>Consideration Received</u>	<u>Conversion Rate Calculation</u>
Basic Data per Indenture	7,037,447	\$351,872.50	
4% Stock Dividend 11/4/58 (4% on 7,038,407 shares at 54.75)	281,537	15,414,151	\$731,898,400
56.875 ÷ 1.04 = 54.75			= 1.9927
	7,318,984	\$367,286,501	\$367,286,501

Translated, the calculation was this: the closing price of the pre-dividend stock on the date of declaration was 56.875; that was divided by 1.04 since there were now 104 shares where there had been 100; the resulting 54.69 was rounded off to 54.75; and the number of shares so issued was multiplied by 54.75 to obtain "the consideration received" - \$15,414,151. Then, the formula in Section 4.05(a) was applied; the new share total (7,318,984) was multiplied by \$100 and that figure (\$731,898,400) was divided by the original consideration (\$351,872,350) plus the "consideration received" for the new shares (\$15,414,151) or \$367,286,501. The quotient was 1.9927.

Except for the immaterial rounding off (without which the quotient would have been 1.9928) the foregoing was an impeccable application of Section 4.05(a) and (b). Boeing entered the following in its Capital Stock Record (Tr. Exh. 6, App. p. 843a):

<u>Description</u>	<u>Shares</u>	<u>Amount</u>	<u>Per Share</u>
"4% Stock Dividend	281,537	\$15,414,150.75	\$54.75

"Comments: Amount transferred from retained earnings - Nov. 4, 1958 market price of $\$56.875 \div 1.04 = 54.75$ ".

On December 17, 1958 Mr. Prince, Secretary of the Company wrote "To the Stockholders" (Ex. 1 annexed to this brief):

"Upon payment of the stock dividend there will be transferred from the retained earnings account to the capital stock account the sum of \$54.75 for each full share issued, or a total of \$15,414,151. This represents the approximate fair value of the stock to be issued in payment of the dividend determined by reference to the approximate market value of such shares on the New York Stock Exchange at the close of business on such Exchange on November 3, 1958, adjusted to give effect to the additional shares of capital stock to be outstanding upon the payment of said dividend." (Underscoring ours).

On March 25, 1959, Mr. O.E. Melby, Treasurer of Boeing, wrote a memorandum for Mr. J.O. Yeasting, the Vice-President-Finance and Mr. E.M. Nelsen (A.E. 20). After repeating the above calculations he said:

"Because of this, the formula results in a calculated rate of 1.9927 shares per \$100 of principal amount of debentures, but the Indenture does not allow the rate to be reduced below 2.00 shares per \$100."

This, too, was absolutely accurate. Section 4.05(a) at the bottom of p. 34 states that if the formula results in a quotient of more than 2.00 then that quotient is carried over to the future. But

"If the resulting quotient, adjusted to the nearest hundredth, is less than the basic conversion rate, as so defined, the conversion rate shall be the basic conversion rate."

What Mr. Melby was saying was that starting with 2.00 as the conversion rate, no shares could be valued over \$50 each for that would reduce the rate below 2.00. Thus, the starting point for the next calculation following this dividend was necessarily:

	<u>Shares</u>	<u>Consideration</u>	<u>Conversion Rate</u>
Original	7,037,447	\$351,872,350	2.00
1958 Dividend	<u>281,537</u>	<u>14,076,850</u>	<u>2.00</u>
	7,318,984	\$365,949,200	2.00

3. The 1959 Stock Dividend

On November 2, 1959, Boeing declared a 2% stock dividend. The stock closed on that day at 30.375 (A.S. 66).

The resolution in which the Board declared the dividend was drafted by Harold F. Olsen, Esq., a member of the firm of Perkins, Cole, Stone, Olsen and Williams, attorneys for Boeing (App. pp. 498a, 563a, App. p. 832a) and read in part (App. p. 834a):

"RESOLVED FURTHER, that upon the payment of the stock dividend as hereinabove directed, the officers of this Company be and they hereby are authorized and directed to transfer from the retained earnings account to the capital stock account the sum of \$29.875 per share for each of the shares of stock required to be issued and distributed pursuant to the foregoing resolutions; which sum is an amount approximately equal to the fair value of such shares determined by reference to the approximate market price of such shares on the New York Stock Exchange at the close of business on such Exchange on November 2, 1959, adjusted to give effect to the additional shares of capital stock to be outstanding upon the payment of said dividend ..." (Underscoring ours)

There was recorded in Boeing's Stock Record (App. 844a):

<u>Description</u>	<u>Shares</u>	<u>Amount</u>	<u>Per Share</u>
"2% stock dividend	147,489	4,406,233.88	29.875
"Amount transferred from retained earnings - Nov. 2 market price of $\$30.375 \div 1.02 = 29.875$ "			

If we accept Mr. Melby's own figures and statements on A.E. 20 and the 1959 dividend resolution, the consideration received, formula-wise, stood as follows after November 2, 1959:

	<u>Shares</u>	<u>Consideration Received</u>	<u>Conversion Rate</u>
Original	7,037,447	\$351,872,350	2.00
1958 Stock Dividend at Maximum Price of \$50	281,537	14,076,850	2.00
1959 Stock Dividend at Market of \$30.375 $\div 1.02$	147,489	4,392,136	
	<hr/> 7,466,473	<hr/> \$370,341,336	2.0161

4. The Vertol Transaction

(a) The Obvious Necessity to Change the Rate

On September 21, 1959 Boeing and Vertol Aircraft Corporation, a manufacturer of helicopters, "initiated negotiations" for Boeing's acquisition of Vertol (A.E. 22, second memorandum, p. 8). By November, 1959, it was evident that if the transaction was to occur it would involve the issuance of nearly half a million shares for Vertol, that the Boeing shares would be issued for a consideration far less than \$50 a share and that a change in the conversion rate would be required.

This was stated in the clearest terms by Mr. J.O. Yeasting, Vice-President-Finance at an informal meeting of nine of the

directors held on November 13, 1959. He said (A.E. 22, p. 2):

"This acquisition will reduce the conversion price of our convertible debentures outstanding which will increase the number of shares to be issued if and when the bonds are converted."

It will be noted that Mr. Yeasting said "will increase" and not "may increase".

The formula made this obvious. At the time he knew that the deal contemplated the issuance of 448,729 Boeing shares for Vertol assets (ultimately 448,954 were issued) and he knew the exact number of Vertol option shares and their prices (A.E. 22, second memorandum p. 10, A.E. 26, 1958 Annual Report, p. 6). So, all he had to do was: Let X = the consideration required if no change was to be made in the conversion rate

$$\frac{\$100 \times 7,939,209}{\$370,341,336 + X} = 2.045 \text{ (minimum requiring immediate change in conversion rate)}$$

$$X = \$17,889,995$$

To place a value of nearly \$18,000,000 on Vertol when its own books showed a net worth of \$13,800,000 at September 30, 1959, (A.E. 22, second memorandum, p. 7) which, as we shall show below was very soon substantially reduced; and when its stock was selling between 19 and 20 1/2 (id., p. 8) or an aggregate of approximately \$12,000,000 to \$13,500,000 was obviously an impossible task for any conventional man.

What followed and what follows in this brief is how Boeing closed the gap. Had it done so in a single maneuver this would be a shorter brief. But it did so in three different steps.

One step was an upward revaluation of about \$2,000,000 for the non-existent "consideration received" for the stock dividends of

1958 and 1959. A second step was to value the price of the shares Boeing gave for Vertol shares at the impermissible date of November 13, 1959; the sum involved here is in seven figures and the exact difference depends on the date one believes to be the correct one. Even these two were not enough so the last \$155,155 were extracted from a patent abuse of the provision of the indenture governing the valuation of stock options.

(b) The November 13, 1959 Meeting

As stated above, Boeing had begun negotiations with Vertol in September. On November 11 or 12, 1959 the Boeing negotiating team submitted its recommendations to Mr. Allen (A.E. 22, second memorandum). Mr. Allen had to "leave town on November 14" (App. pp. 400a-401a) so on November 12 he mailed or delivered to Boeing directors copies of the recommendations and on November 13 a "rather hurriedly called" meeting was held (App. p. 397a). It was attended by the seven management directors and the two "outside directors" who resided in the Seattle area, the other four "outside directors" being unavailable (A.E. 22, App. pp. 373a-374a)

The Boeing negotiating team recommended acquisition on this basis: Vertol had 673,093 shares outstanding; allow Vertol to declare a 5% stock dividend and then give two Boeing shares for each three Vertol shares (A.E. 22, second memorandum, pp. 8, 10). This meant 2.1 shares of Boeing for 3 Vertol.

The nine Boeing directors present expressed conflicting opinions (A.E. 22, first memorandum). One director said that "based on his own analysis, he was inclined not to favor the proposal" (p. 4). Another said "that he was inclined to not favor the proposal" (id).

We have quoted Mr. Yeasting's objections on conversion rate grounds; he had other reasons too. Another director thought we were in the area of trading" (p. 5). Another felt "there might well be a substantial potential" (id). Mr. Allen said that since "there were differing views ... he thought the Company should not undertake such a venture" (pp. 6-7). The consensus was that management should proceed with the negotiations but on a basis of 2 for 3 only and not on the 2.1 for 3 basis which a 5% stock dividend by Vertol would permit.

The tentative status in which the Vertol negotiations stood on November 13, 1959 is revealed at p. 6 of the memorandum:

"Mr. Prince pointed out the background of the provision on the contingent stock dividend ... it had been extremely difficult to reach a tentative agreement with the Vertol management ... that this 5% stock dividend contingency was a compromise finally offered to reach agreement."

And, the final paragraph of the memorandum (on p. 7) shows that even on the Boeing side no "firm decision to proceed" had been reached on November 16, 1959. We quote that paragraph in full:

"During the course of the meeting Mr. Allen advised that there had been an attempt to contact the directors who were not present; that Mr. Gates was the only one who had been contacted and he had not yet had an opportunity to read the memo of November 11, but to the extent possible they would be contacted. Mr. Prince, on November 16 and prior to a firm decision to proceed, talked with Mr. Gates and Mr. Schaefer after they had each gone over the memo of November 11 and Mr. Allen's memo of November 12, and they were generally briefed on the proceedings at the meeting on November 13. Both approved going forward

with the proposal although both acknowledged that they, likewise, had certain reservations similar to those expressed in the meeting. Mr. Allen and Mr. Prince did not succeed in talking to Mr. Forward, who was in Jamaica, although several attempts to do so were made. Mr. Reed was not contacted as it was understood that he was travelling" (Underscoring ours)

The uncertainty of the negotiations on November 13th is well-expressed by Mr. Allen:

"The Boeing people moved forward in accordance with the decision that was made at the meeting on November 13th to, hopefully, consummate the negotiations that were authorized. In other words, to come to a conclusion with Vertol, either come to a conclusion or if Vertol said no, why, to drop the matter. But the directors had given a decision and the management moved to carry that out.

Q. Did you know on November 13th whether the Vertol management would accept the proposal of three for two?

A. I would assume they would accept the three for two provision, but, remember, we struck out the reservation about their being able to declare a stock dividend, and I didn't know whether that would kill the deal or not." (App. p. 426a)

(c) The Continuing Vertol Negotiations

The minutes of the Boeing Directors' meeting of December 7, 1959 recite:

"Mr. Prince outlined the status of negotiations with Vertol, looking toward the possible acquisition of that Company by Boeing, and reported that if agreements were reached, it was tentatively planned to submit a Plan and Agreement of Reorganization to the Board of Directors of each company on January 18 ... He further reported that the Company had just received an inquiry from the United States Department of Justice ... on the anti-trust aspects of the proposed acquisition" (A.S. Par. 70, A.E. 23, fifth page).

One item, the importance of which will appear below, had not even been discussed on November 13, 1959. That was the stock options in Vertol held by Vertol employees. A.E. 29 at p. 2, a letter from Boeing's investment bankers, reads:

"We are told that at the time of the commencement of negotiations with Vertol, shortly after the November 13 decision date, no formal proposal was made for an exchange of Boeing options for Vertol options. The basis for the exchange of options was arrived at later in the negotiations."

Judge Ryan found (App. p. 311a):

"While it is true, as plaintiffs point out, that on November 13, 1959 the matter of the acquisition was still tentative and does not appear to have been settled until sometime in December at the earliest and that the date the contract was signed appears more rational, this Court cannot say that the Board of Directors had no colorable right to fix the 'fair value' of the consideration as of November 13, 1959."

Precisely when the contract was signed we do not know. It is "dated as of the 18th day of January, 1960" (A.E. 24, p. 1) which is the date on which the Boeing Board "formally authorized the execution of the Plan and Agreement" (A.E. 25, p. 7).

The closing was on March 31, 1960.

5. Revision of the Calculations of the Stock Dividends

As Judge Ryan noted, above, the negotiations were concluded "at the earliest" in December.

Under date of December 17, 1959, now fully aware of the effect of Vertol on the conversion rate, Boeing revised its calculations of the year before with respect to the November 4, 1958 4% stock dividend.

Whereas it had determined that that dividend brought a quotient of 1.9927 (p. 10 above) and that consequently the rate stayed at 2.00 (p. 11 above) it now revised that calculation in two respects:

1) it no longer divided the closing price of the pre-dividend share by 1.04 but took the full pre-dividend share price of 56.875 as "the consideration received", arriving at 1.9895 and
 2) it no longer took 2.00 as the irreducible minimum but began its next calculation at 1.9895. It then, on December 17, 1959, despite the recent resolution of November 2, 1959 as to the "fair value" of the dividend shares, took the full price of the pre-dividend shares on November 2, 1959 for the 1959 calculation.

Thus, A.E. 21 reads:

	<u>Shares</u>	<u>Consideration</u>	<u>Rate</u>
Original	7,037,447	351,872,350	2.00
1958 Dividend	<u>281,537</u> 7,318,984	<u>16,012,417</u> 367,884,767	<u>1.9895</u>
1959 Dividend	<u>147,489</u> 7,466,473	<u>4,479,979</u> 372,364,746	<u>2.0052</u>

By reversing its computation and treating the 1958 quotient at 1.9895 rather than 1.9927 (a difference in "consideration" of \$598,266) and by not, then, returning to the irreducible minimum of 2.00, Boeing added "consideration received" of \$1,935,567 from the 1958 dividend and \$87,843 from the 1959 dividend.

This closed more than \$2,000,000 of the gap between 1) an acquisition which went on Boeing's books at \$12,435,000 at a time when the Boeing shares issued for it were selling at \$10,775,000 and 2) the \$17,245,481 needed to avoid change in the conversion rate, (after allowing for the \$644,514 from the option shares).

The significance of the difference between 2.0161 and 2.0052, i.e. .0109, may be seen in better perspective when we say that it is 54 1/2 times as great as the .0002 by which Boeing claims it avoided a change in the conversion rate.

6. The Conditions Included in the Vertol Contract

At p. 18 above, we quoted Judge Ryan's opinion that fixing the value of Vertol on the date of the contract "appears more rational" than fixing it as of November 13, 1959. We agree. But we think that it would have been still more rational to fix the "value" of the "consideration received" on the date that the consideration was received, namely, the closing date of March 31, 1960. We say this although except for a relatively small amount of the damages, the end result here would be the same whether January 18th or March 31st were taken.

The contract "dated as of January 18, 1960" left open many important matters as conditions precedent to closing (A.E. 24). Vertol was required to obtain, prior to the closing date, "all necessary consents of others", presumably lienors, to the transfer of "all material, properties and agreements (other than agreements with the United States government or agencies thereof)"; and Vertol agreed "to use its best efforts" to obtain consent of the United States Government to an assignment of Vertol's Government contracts "through appropriate novation agreements" (p. 5). There were four long printed pages of "Conditions Precedent", divided approximately equally between the two parties (pp. 9-12). A meeting of Vertol stockholders had "to be called and held on or prior to February 24, 1960" for their approval of some of the transactions involved (p. 5). If as many as 15,000 Vertol stockholders dissented, the deal was off (p. 9). Another condition was that there be no "material adverse change in the financial condition, business or otherwise between September 30, 1959 and

December 31, 1959" and that there be a letter from Lybrand, Ross Bros. & Montgomery to the same effect for the period between December 31, 1959 and March 26, 1960 (pp. 10-11).

The record does not disclose precisely what Vertol made or lost between September 30, 1959 and December 31, 1959 but it does disclose that between December 31, 1959 and March 31, 1960 the pre-tax loss was \$988,636 (A.E. 26, seventh page) and that the net worth, after taxes, declined \$1,311,086 (id., sixth page). With a total equity in the \$12,000,000 range this might have been regarded as "materially adverse" but the point is that the lost million was hardly "consideration received" by Boeing.

As we pursue the matter in our Argument we shall urge that the foregoing support our position that valuing the "consideration received" would have been most rationally done as of the date of receipt of that consideration.

7. The Closing

The closing was held on March 31, 1960. On that day, Boeing delivered 448,954 shares of Boeing stock in exchange for Vertol's assets and granted stock options to Vertol employees to purchase 23,782 shares of Boeing stock (A.S. 71, 72). On that date, Boeing stock closed on the New York Stock Exchange at 24 (A.S. 74). The option prices aggregated \$644,514, an average of \$27.10 a share (A.S. 72).

8. Valuing the Consideration Received
for the Shares Issued and for the
Options Granted for Vertol

(a) Who Did the Valuing - the Conflict of Interest

The seven management members of the Board owned 53,977 shares; the exact number of shares for which they held stock options we do not know, but we do know that they received options on 9350 shares in 1958 and 21,500 shares in 1959 (App. pp. 827a, 829a, 327a). Non-management directors owned more than 9000 shares (id).

The Board's conflict of interests was described by Boeing's counsel, Mr. Olsen, in a letter to it dated April 4, 1960 (A.E. 31, p. 2):

"But you will observe that under the terms of Sec. 4.05 of the Indenture it is to the benefit of the owners of the Convertible Debentures to have the assets received from Vertol valued as low as possible, while a higher valuation would be to the present stockholders' advantage. This conflict of interests dictates that care be taken to insure that if the Directors' valuation of the assets should ever be challenged, their careful and thorough analysis of the matter and their good faith in the determination could be convincingly demonstrated." (Underscoring ours).

Mr. Allen testified at Tr. p. 81:

"A. ... I was interested in doing the best thing for the Boeing Company, whatever that might be.

"Q. And for the stockholders in the Boeing Company, is that correct?

"A. It would be difficult to differentiate between the two.

"Q. Well, is it difficult to differentiate between the stockholders and the debenture holders?

"A. They have different interests, yes, but we certainly had the interests of the debenture holders in mind as well. It was our obligation."

At App. 382a, Mr. Allen testified:

"THE COURT: Did you in all of your acquisitions take the possible dilution of the common stock of Boeing into consideration as one of the factors in your deal?

"THE WITNESS: That question was asked at the time that we fixed fair value of the stock of the Vertol Company. One director -- and I can't tell you who it was, I don't remember -- asked what the amount would be beyond which if it were lower than that there would be an effect on the conversion factor, and that answer was given, and it appears in the minutes, but there was no discussion of it, as I recall. It was simply an inquiry.

...

"THE COURT: Do the minutes show that the directors were conscious of that?

"THE WITNESS: Oh, yes.

"THE COURT: And you yourself were conscious of that?

"THE WITNESS: Yes. But our mission, your Honor, was a determination of fair value."

(b) The Board Meeting at Which the Value Was Determined

On April 4, 1960, the Board met. One of its purposes was to determine "the fair value" of Vertol for purposes of the conversion rate of the debentures. The minutes are A.E. 25. Mr. Allen "asked Mr. Haynes to review this subject" (p. 5).

In our opinion, Mr. Haynes' presentation created an indefensibly false picture and we propose now to give his statements of fact followed by facts in the record which demonstrate the character of the evidence and the computation on which the "determination of fair value" was made.

The minutes recite (p. 5):

"Mr. Haynes stated that in order to protect the holders of the Convertible Subordinated Debentures against dilution of the value of the convertible features of the Debentures upon the issuance of additional shares of capital stock of the Company after the date of the indenture, the indenture provides that if any shares of stock are issued for a consideration less than \$50 a share, an adjustment in the conversion rate may be required..."

The minutes continue at page 5:

"Mr. Haynes further stated that for the purpose of recording the acquisition of the assets and business of Vertol on the books of the Company, the transaction is treated as a pooling of interests which means that the assets, liabilities and earned surplus of Vertol are recorded on Boeing's books at the same figures at which they were carried on the Vertol books as of the date of acquisition; and that the portion of Vertol's net worth represented by its capital stock and capital surplus accounts will be recorded in Boeing's capital stock account at the same amount at which these accounts were carried on the books of Vertol as of the date of acquisition."

Comment. The above was true but Mr. Haynes did not tell the Board that the amount at which the Vertol net worth was being put on Boeing's books was \$12,435,138.47 or more than \$2,800,000 less than the valuation he would propose (A.S. 76).

Next:

"Mr. Haynes pointed out that the net book value of Vertol's tangible assets was approximately \$13,799,000 on September 30, 1959 and approximately \$13,460,000 on March 31, 1960; and that certain adjustments would be made to these figures when recorded on Boeing's books."

Comment. This statement was untrue. We must assume that "net book value of Vertol's tangible assets" meant "net worth" for three reasons: 1) the figure of \$13,799,000 on September 30, 1959 corresponds with \$13.8 million for "Stockholders Investment" and \$20.50 book value for each of 673,093 shares on that date

(A.E. 22, second memorandum, pp. 7, 10); 2) there is no other such figure in the record and 3) we cannot find the phrase "net book value of tangible assets" in any accounting book.

The truth is that the net worth of \$13,799,000 on September 30, 1959 had shrunk on March 31, 1960 not by \$339,000 to \$13,460,000 but had shrunk, as reported to the S.E.C., by \$1,184,980 to \$12,614,020 (A.E. 25, sixth page) and even that figure had been adjusted downward by Boeing nearly \$180,000 to \$12,435,138.47 (A.S. 76).

Mr. Haynes then stated that the book value did not take into account intangible values, such as "value of drawings, data and other intangible assets".

The minutes continue (p. 6):

"Mr. Haynes stated that no detailed appraisal of either the tangible or intangible assets of Vertol had been made as a part of this transaction; but that an appraisal of tangible assets of Vertol was made as of December, 1958 by Manufacturer's Mutual Fire Insurance Company and based on that appraisal with appropriate adjustments to date to give effect to additions and retirements of certain assets, it would appear that the appraised value of the tangible assets should be approximately \$17,350,000 without including any amount for drawings and technical data which are presently insured at a replacement value of approximately \$6,000,000."

Comment. Mr. Haynes did not give the Board the amount of the insurance company appraisal in December, 1958. The following contrast between insurable property in December, 1958 and March 31, 1960 (A.E. 26) should have been brought to the attention of the Board:

	<u>December 31, 1958</u>	<u>March 31, 1960</u>
Property, Plant and Equipment (Net)	\$ 7,129,017	\$ 4,481,288
Inventories (Net of Progress Billings)	9,304,008	8,173,773
Progress Payments (presumably against work in progress and insurable)	<u>1,461,384</u>	<u>335,707*</u>
	\$17,894,409	\$12,990,768

* This is the December 31, 1959 figure; not available for March 31, 1960.

Thus, the \$17,350,000 "adjusted" to the insurance appraisal is close in December, 1958 (and perhaps exact after deducting land value) but the decrease of \$4,900,000 in insurable value should have been brought to the attention of the Board if it was to be told about the December, 1958 insurance appraisal at all.

The minutes continue (p. 6):

"Mr. Haynes then pointed out that the average earnings of Vertol for the five year period ending December 31, 1959 were approximately \$1,550,000; and that if it could be assumed that the assets and business of Vertol would produce similar earnings in future years, a fair value of such assets and business based on such average earnings capitalized at 6%, a rate commonly used for this purpose, of approximately \$17,000,000 would be reasonable."

Comment. We shall assume that the average for five years was \$1,550,000 (A.E. 26 does not go back of 1956). What Mr. Haynes did not tell the Board was that the average was that high by virtue of earnings of several years back, that the earnings had been in steep decline since 1956 and that Vertol was now losing money. Far more relevant than the average was the following sequence (A.E. 26):

<u>Year</u>	<u>Earnings or (Loss)</u>
1956	\$3,437,563
1957	1,656,768
1958	869,553
1959	235,299
1960 (3 mos.)	(988,636)*

* Loss before tax credit

No fair presentation could have omitted mention of steadily declining earnings and the loss of nearly a million dollars in the past three months.

Instead, Mr. Haynes had the temerity to suggest capitalizing the five year average earnings at 6% "a rate commonly used for this purpose."

We now come to the crucial part of Mr. Haynes' report. He did not predicate his recommendation on a) appraisal or b) capitalization of earnings or c) book value but allegedly, and we stress allegedly, on the closing price of Boeing stock on November 13, 1959, the date of the informal meeting.

At p. 7, a new thought enters the minutes: "Mr. Haynes then stated that with regard to the use of the market value of Boeing stock as a basis for valuing the assets and business of Vertol, the directors were well aware that there had been considerable fluctuations in the market." In the last six months of 1959, the high had been 36 in July, three months before negotiations with Vertol began (A.E. 22 second memorandum, p. 8). Why that was relevant we do not know since Mr. Haynes was not suggesting averaging

prices. In September, when the negotiations did begin, the stock hit its low for the six months, 30. On November 13, the date he said when management was "authorized by an informal meeting of the directors to make a firm offer to Vertol" the stock closed at 33 5/8. (Contrast this statement with A.E. 22, p. 7 where Mr. Prince's memorandum of the November 13 meeting says "on November 16 and prior to a firm decision to proceed"). The highest closing price "since that time", he said, was 35 3/8 on November 27. On January 18, 1960, "the date the directors formally authorized the execution of the Plan and Agreement" it was 30 5/8. On March 30, the day before the closing, it was 24 1/8. He might have added that on March 31st it closed at 24.

Mr. Haynes then stated:

"Mr. Haynes then pointed out that the November 13 closing market price of \$33-5/8 multiplied by the total number of shares that may be issued as a result of the agreement and adjusted for the amount the Company will receive upon the exercise of Vertol stock options would produce a value of approximately \$15,250,000. By the same type calculation a value based on a closing market price of \$24-1/8 on March 30 would be \$10,831,000."

Comment. This statement was inaccurate, misleading and indefensible. Since it encompasses two clear breaches of the indenture we shall devote a separate section to it.*

The minutes then read:

"Upon question from one of the directors, Mr. Haynes stated that a calculation had been made as to the minimum value that could be placed on the assets of Vertol without an

*It is interesting to note that the two calculations are not based on "the same type calculation." $448,954 \text{ shares} \times 33.625 = \$15,096,078.25$ not \$15,250,000. $448,954 \text{ shares} \times 24.125$ does equal \$10,831,000. The reason for Mr. Haynes' misstatement will appear in the next section. The former figure is "doctored". The latter is not.

adjustment in the conversion price being required; and that such figure as adjusted for the amounts to be received upon the exercise of options (approximately \$644,000) was approximately \$15,216,000".

The Board adopted a resolution based on Mr. Haynes' recommendation, valuing the "consideration received" for the Vertol asset shares at \$15,250,000.

(c) Mr. Haynes' Computations of the
Consideration Received for Shares
Issued to Vertol and Options Granted

It will be recalled that the option shares were to be valued under Section 4.05 (b)(v) at the option price and that the asset shares were to be valued under Section 4.05(b)(ii) at "the fair value thereof as determined by the Board of Directors."

It is stipulated that in reaching his figure Mr. Haynes calculated the option shares at the market price of November 13, 1959 and not at the option price. A.S. 81 reads as follows:

"The November 13, 1959 closing price on the NYSE of 33 5/8 for Boeing Capital Stock was multiplied by 472,736 shares [448,954 shares being the shares issued in connection with the acquisition of the assets of Vertol and 23,782 shares being the shares which would be issued to Vertol employees in connection with the stock options granted to them by Vertol prior to the acquisition] giving a product of \$15,895,748. From this figure there was subtracted \$644,514 which was the amount Boeing would receive upon the exercise of the Vertol stock options and this leaves an amount of \$15,251,234, which was rounded off to \$15,250,000".

Mr. Haynes undoubtedly found that if he multiplied the 448,954 asset shares by the closing price on November 13, 1959, the most favorable date he could find, he would arrive at \$15,096,078.25; and by adding the option price of \$644,514, he

would have to increase the conversion rate. Starting with Boeing's revised stock dividend calculation and thereby abusing the indenture by .0109 (see p. 19 above) he still could not avoid adjustment. On that revised basis the calculation would be:

	<u>Shares</u>	<u>Consideration</u>	<u>Rate</u>
After the stock dividends (p. 17 above)	7,466,473	\$372,364,746	2.0052
Vertol assets	448,954	15,096,078	
Vertol options	<u>23,782</u>	<u>644,514</u>	
	7,939,209	\$388,105,338	2.0456

Thus, the nearest hundredth being 2.05, even on that basis the rate would have been increased.

So, Mr. Haynes pulled a trick. He took the option shares not at the option price but added the 23,782 shares to the 448,954 asset shares, multiplied the total of 472,736 by the closing price of 33 5/8; then subtracted the option price of \$644,514. Thereby, he added \$155,155.25 to the asset shares. So added, the 448,954 asset shares come to 33.968 a share against a closing price of 33.625.

Whether the \$155,155.25 is regarded as violating Section 4.05(b)(v) which seems to us the case, or as charging the asset shares at higher than the closing price on November 13, 1959 is not material. In either case the debentureholders suffered because no one was there to look over Mr. Haynes' shoulder.

Starting with the correct stock dividend computation (see p. 17 above) the figures, even on a November 13, 1959 basis for Vertol, should have been .0109 higher and the quotient would have

been 2.0565 resulting in a 2.06 conversion rate.

Mr. Haynes explained none of this to the Board. The Board knew only that "the total number of shares ... adjusted for the ... stock options" would produce \$15,250,000.

If the Board cared, it was misled. But whether it cared is questionable in the light of the question from one member as to how high they had to go to defeat increase of the rate (A.E. 25, p. 8); and in the light of the fact that when the answer was \$15,216,000 they picked \$15,250,000.

That the Board's decision was based on Mr. Haynes' calculations, the testimony left no doubt. The Transcript, p. 57 (App. 370a) reads:

"Q. (By Mr. Gillespie): "And you took, as I understand it, the market value at the close of November 13th when you made or authorized management to make the offer?

A. (Mr. Allen): That is right, and that, of course, took into account the very factor I am talking about" (Tr. p. 57):

(d) Boeing's Efforts to Find a Satisfactory Calculation

In this respect A.E.'s 27 and 28 speak for themselves.

In A.E. 27 Boeing tried to find primarily by using Vertol figures what it needed to avoid change in the conversion rate. The last two computations on the page show that with revised calculation of the stock dividends, it was found that Vertol stock taken at 21.875 would defeat adjustment but Vertol stock at 21.75 would still require adjustment. Unfortunately for Boeing, Vertol did not reach even the lower price (A.E. 22 second memorandum, p. 8). Every theory tried on A.E. 27 resulted in increasing the conversion rate: Vertol's book value on

November 30, Vertol's book value of November 30 adjusted, Vertol's stock market price on January 31, 1960 and Boeing's stock market price on an unspecified date in 1960.

A.E. 28 is dated 4/12/60 but apparently its calculations were in Mr. Haynes' hands at the April 4 meeting. It shows that starting with the revised stock dividend calculations, Boeing first ascertained how much it needed to avoid adjusting the rate. To produce only 2.044999 it needed from the Vertol deal the sum of \$15,860,823 ("Alternate (1) Lowest Value Without Change"). On the left the sum of \$644,514 was deducted for the option shares and the sum of \$15,216,309 was needed for the assets. The calculation showed that a change could not be avoided by using Vertol's net worth at March 31, 1960 or by using Boeing's stock price at March 31, 1960 or Boeing's stock price at March 30, 1960. The only ways available were Boeing's stock price on November 13, 1959 on all of the shares including the option shares (Alternate (4)) and an arbitrary figure of \$15,250,000 (Alternate (6)). These two ways brought 2.0448 or .0002 below the breaking point.

We ask the Court to note that the date first taken for Boeing's stock price was March 31, 1960, not November 13, 1959.

(e) The Miscalculations Were Consistent
With Boeing's "Basic Objective"

Proof that Boeing's "basic objective" in connection with the debentures was to minimize conversion comes from Boeing's own memoranda.

In 1960 and 1961, Boeing considered calling the debentures

for redemption. We quote from memoranda of the Treasurer, the Vice-President, Finance and the Secretary.

On June 16, 1960, Mr. Melby, the Treasurer wrote:

"In dealing with this question .. we should evaluate it from three points of view: (1) our estimated money requirements, (2) the potential dilution to the present stockholders, and (3) the affect [sic] on our credit line banks.. .

"If this dilution does seem unnecessary as time goes on, we always have the right to call the bonds and if done so before the market price reaches the conversion price, conversion would be nominal." (A.E. 32, second memorandum, p. 2).

2. On June 28, 1961, Mr. Haynes the Vice-President-Finance wrote:

"A risk that should be fully understood concerns stock price levels during the period from the date of the call notice to the redemption date. If during such period the market for Boeing moved up to a point fairly close to the \$52.25 redemption price, conversions could be forced.

"This would not only defeat our basic objective of avoiding dilution but would also result in our having to capitalize the unamortized debt expense ..." (Underscoring ours) (A.E. 33, p. 8).

3. On July 20, 1961, Mr. Prince, the Secretary, wrote:

"Mr. Forward was, in general, opposed to this course of action, but in part based on a misunderstanding, I thought, of what the real objective was. At least as far as I was concerned, this was not a move aimed primarily at reducing our long-term debt, but rather to avoid prospective dilution of the equity position of the stockholders." (Underscoring ours). (A.E. 34)

(f) The Testimony on the November 13, 1959 Date

Mr. Samuel Pivar testified for plaintiffs. He is a member of the firm of Seidman & Seidman, a national firm of Certified Public Accountants, its national director of accounting and auditing practice and its national director of SEC practice, a member of the Executive Committee of the auditing standards division of the American Institute of Certified Public Accountants and Chairman of the Accounting Principles Committee of the New York State Society of Certified Public Accountants (App. 584a). An hypothetical question embodying the foregoing facts was presented to Mr. Pivar (App. 606a-609a) and he was asked his opinion as to

- a) whether November 13, 1959 was a proper date for the pricing of Boeing stock, and
- b) whether Mr. Haynes' inclusion of the option shares in his calculation was proper.

His answer (App. 609a-610a) was as follows:

"I would not consider the November 13th, 1959 date appropriate for making the determination because the parties had not reached an agreement.

"From your description with reference to the decision not to, as I recall it, not to go along with the request for a 5 per cent stock dividend this would appear to me as a counter offer, perhaps, and therefore that date would not have any significance to me, or at least, not enough significance to warrant the use of the price on that date for valuation of the shares issued.

"As to the use of the 33.968 [the price of the 448,954 shares given for assets when computed in Mr. Haynes' way] I think it was, which was the result of having made a calculation which started out with something, I think it is stock options, and then subtracting out, I would not consider it appropriate to use that figure because it is a calculated figure

which ends up higher than the market price of the shares on that date, and I would consider that in any event the market price of the shares of that date would be the upper limit."

(g) The Computations Under the Various Possibilities Urged

There are two factors in computing the conversion rate as to which there can be no difference: 1) the original number of shares and original value thereof and 2) the pricing of the option shares.

On the stock dividends, the following have been urged by one side or the other at one time or another:

- 1) the 1958 dividend should be taken at 2.00 and the 1959 dividend at market \div 1.02;
- 2) the 1958 dividend should be taken at 2.00 and the 1959 dividend at full market price;
- 3) the 1958 dividend should be taken at market \div 1.04 and the 1959 dividend at market \div 1.02;
- 4) both dividends should be taken at full market.

On the Vertol assets, the following have been considered as the date for valuing the shares:

- 1) November 13, 1959 by Boeing
- 2) January 18, 1960 said by Judge Ryan to be "more rational" (we are in accord).
- 3) March 31, 1960 for which we contend.

In the following tables we present all of these possibilities.

TABLE 1

THE STOCK DIVIDENDSCONSIDERATION RECEIVED

	(1)	(2)	(3)	(4)
	2.00 for 1958 Market + 1.02 for 1959	2.00 for 1958 Full Market for 1959	Market + 1.04 for 1958 Market + 1.02 for 1959	Full Market for 1958 and 1959
<u>Shares</u>				
Basic	7,037,447	\$351,872,350	\$351,872,350	\$351,872,350
1958 Stock Dividend	281,537	14,076,850	15,414,151	16,012,417
1959 Stock Dividend	<u>147,489</u>	<u>4,479,979</u>	<u>4,392,126</u>	<u>4,479,979</u>
	7,466,473	\$370,341,336	\$371,678,637	\$372,364,746
Conversion Rate	2.0161	2.0156	2.0089	2.0052

TABLE 11

VERTOLCONSIDERATION RECEIVED

	(1)	(2)	(3)	(4)
	2.00 for 1958 Market ÷ 1.02 for 1959	2.00 for 1958 Full Market for 1959	Market ÷ 1.04-1958 Market ÷ 1.04-1959	Full Market 1958 and 1959
<u>SHARES</u>				
From Table I	7,466,473	\$370,341,336	\$371,678,637	\$372,364,746
Add Vertol Options	23,782	644,514	644,514	644,514
Vertol Assets at November 13, 1959 (33.625)	<u>448,954</u> <u>7,939,209</u>	<u>15,096,073</u> <u>\$386,081,928</u>	<u>15,096,078</u> <u>\$387,419,229</u>	<u>15,096,078</u> <u>\$388,105,338</u>
Conversion Ratio	2.0564	2.0560	2.0493	2.0456
Vertol Assets at January 18, 1960 (30.625)	<u>13,749,216</u> <u>\$384,735,066</u>	<u>13,749,216</u> <u>\$384,822,909</u>	<u>13,749,216</u> <u>\$386,072,367</u>	<u>13,749,216</u> <u>\$386,758,476</u>
Conversion Ratio	2.0636	2.0631	2.0564	2.0528
Vertol Assets at March 31, 1960 (24)	<u>10,775,006</u> <u>\$381,760,856</u>	<u>10,775,006</u> <u>\$381,848,699</u>	<u>10,775,006</u> <u>\$383,098,157</u>	<u>10,775,006</u> <u>\$383,784,266</u>
Conversion Ratio	2.0796	2.0792	2.0726	2.0689

D. The Notice of Call for Redemption of the Debentures

1. The Decision to Call

In January and February, 1966, Boeing discussed a new financing program (A.S. 95). The debentures were not involved because they in no way hindered the new financing (A.S. 100).

Call of the debentures, which as noted above, had been discussed in earlier years, was first mentioned in 1966 on February 18 (A.S. 96,97). On February 24, management decided to call the debentures and on February 28, the Board incorporated the call into a resolution to split Boeing stock (A.S. 103, A.E. 38).

In none of the discussions was consideration given to protecting holders of debentures worth 3 1/2 times the redemption price from loss (A.S. 103(e), 106, 107). On the contrary

"If called at trial, H.W. Haynes would testify that both prior and subsequent to the Board of Directors meeting held on February 28, 1966 and prior to the call for redemption of the debentures the notice requirements for call thereof were considered by Boeing and its counsel, Boeing's investment banking advisors and their counsel, and Chase and its counsel. Mr. Haynes would further testify that they were all of the opinion that the notice called for in the indenture was the only notice required." (A.S. 122).

Certain conclusions are obvious. The question which occupied so many people was whether notice in addition to that specified in the indenture was "required". They must also have considered the kinds of additional notice which might be given if additional notice was "required". And they were too well informed to have to discuss press releases required by the New York Stock Exchange.

This leads us to the question of which forms of notice did they reject as not "required"?

2. The "Notice" Given

On March 8 and March 18, 1966 Boeing published in the Wall Street Journal notices, each 5 inches by 5 1/2 inches, informing holders that the debentures were being called for redemption on April 8, 1966 at the price of 103 1/4; that the conversion rate was 2 shares for each \$100; and that conversion rights would expire at the close of business on March 29, 1966 (A.E. 46). Boeing contends that this was the only notice it was required to give.

On March 28, 1966, Boeing published the same formal advertisement in the New York Times and in the Wall Street Journal. It is not contended that these conformed to the indenture; if for no other reason they did not comply because they were not "in successive weeks" (A.E. 4, p. 41).

As Judge Ryan pointed out, immediately after this gesture of unrequired publication "more than \$9,000,000 of these were converted" (App. 298a). We do not attribute this surge entirely to the New York Times but we agree with Judge Ryan that the fact is worthy of note. Perhaps publication in the New York Times was one of the matters pondered by all of the lawyers, bankers and officers who decided that notice beyond the words of the indenture was not "required".

The holders of \$1,544,300 of the debentures, worth, under the New York rule, approximately \$5,850,000 did not see any of the advertisements and failed to convert. Their tenders after March 29

were refused and it is stipulated that those who did not tender would have been refused if they had tendered for conversion (A.S. 155, 164).

3. Boeing's Proof of Other Publication

Boeing cites the facts that notice of the call was "carried" on the New York Stock Exchange Ticker and was printed in the New York Stock Exchange Bulletin, the Commercial and Financial Chronicle, Standard & Poor's Bond Outlook, Standard & Poor's Called Bond Record, Moody's Industrials, the Seattle Post Intelligencer, the Seattle Times, the Financial World and the Bond Tables in the New York Times. (In the "Times" in the listing of the bonds one can detect the letters "cld" after the name of the bond). The only non-Seattle newspaper article cited (Tr. Exh. D., App. p. 39a) shows the information so lost in the middle of the article that someone circled it.

Would any member of this Court have been apt to come by the information as above provided? A Judge of the Tax Court, a bank in Miami and a soldier in Viet Nam did not.

A sampling of the holders indicates that most of them held debentures ranging from a face of \$100 to \$500 (App. p. 3a).

This distribution of "notice" may now be compared with means shown in the record to be readily available to Boeing.

4. A Letter to Stockholders

We pointed out above that approximately 76% of the debentures were bought initially by stockholders.

Under date of February 28, 1966, Mr. Allen addressed a letter to stockholders (A.E. 37). The S.E.C. was notified at least twice that it was proposed that this letter be "released to stockholders on or about March 24, 1966" (A.E.s 44, p. 3, 45, p. 1). Even that was five days before the cutoff date of March 29, 1966. The letter was actually mailed with a proxy statement and the 1965 Annual Report "between March 24 and March 30, 1966" (A.S. 139).

That letter does not mention the debentures or the call of the debentures. (A.E. 37, top page). The letter tells of an impending stock split and of the granting of certain employee's incentives. The proxy statement says that no nominee for director "owns" any of the debentures (A.E. 37, p. 4). The Annual Report lists the debentures outstanding at December 31, 1965 (A.E. 49 under "Long Term Debt and Restrictions on Earnings").

How many holders would have been spared a loss by a letter notification of the call mailed on February 28 or March 8 or even March 24 no one can tell. As we shall show the cost of such a letter "would not have been substantial" (A.S. 55).

5. A Letter to those Who Exercised the Warrants

97% of the debentures were purchased by exercise of warrants (A.S. 46). The warrants with the names and 1958 addresses of all of those who exercised the warrants were in the possession of Boeing's agent (A.S. 45). It is stipulated:

"If the warrants had been turned over to the printer, the cost of preparing, printing, addressing and mailing such a letter to the parties exercising the warrants in 1958 would not have been substantial." (A.S. 55)

How many holders would have tendered as a result of a letter sent at insubstantial cost to those who exercised the warrants no one can tell.

6. A Letter to those who Collected
January 1, 1966 Coupons

Coupons had been payable as recently as January 1, 1966.

We believe that it is common knowledge that coupons are converted into cash by depositing them in banks in envelopes bearing the names and addresses of the depositors. Nevertheless, we served requests for admissions which contained sample copies of the envelopes used by Morgan Guaranty, Manufacturers Hanover, Sterling National and Emigrant Savings Banks. (App. 86a-88a). We requested admissions 1) that these envelopes were typical of those used by First National City, Chase, Chemical and the Federal Reserve Bank, all of New York; by Central Penn National Bank and Continental Bank of Philadelphia and by Fulton National Bank of Atlanta and 2) that the envelope method was typical and general throughout the United States (App. 87a, 89a). Defendant admitted that such was the practice of each of these ten banks but professed to lack "information or knowledge as to the general financial practice throughout the United States" (App. p. 95a). Judge Ryan cut off counsel who wished a statement from Boeing as to what efforts it had made to ascertain whether the practice of these ten banks was a general one (App. p. 618a).

Similarly, Boeing admitted that it was the practice of every bank we named to collect and to forward the coupons of each issue in a single envelope to the paying bank (in this case,

Chase) but Boeing said that it "lacked" knowledge that that was a general practice (Request No. 3, App. pp. 90a, 96a).

Boeing also admitted that all of the banks we named retained either the envelopes or a record of the names and addresses thereon for at least six months after the coupon dates (Request No. 6, App. p. 91a, 98a).

Plaintiff's Request No. 8 (App. pp. 91a, 99a) was admitted as follows:

"Request 8

Between February 28, 1966 and April 8, 1966 Chase Manhattan Bank was able to supply to Boeing:

(a) the name and address of every holder of the debentures who received directly from Chase payment of the January, 1966 coupon;

(b) the name and address of every depositor's bank which received directly from Chase payment of the January 1, 1966 coupon for one or more holders of the debentures;

(c) the name and address of every collecting bank which received from Chase payment of the January 1, 1966 coupon for one or more holders of the debentures or for such holders' depositor's bank.

"Response

Admitted."

It would have required very little effort to circularize every individual who and every bank which had collected the January 1, 1966 coupons and in the case of the banks to ask them to reach the depositors. This would have given effective notice to the current holders.

7. Notice Could Have Been Given to those
who Deposited July 1, 1966 Coupons

The debentures being no impediment to the new financing, Boeing needed only to await deposit of July 1 coupons to have direct contact with the holders.

When the debentures were issued Boeing set aside and reserved 611,952 shares for conversion (A.S. 27). On February 28, 1966 the reservation was intact except for prior conversions (A.S. 118).

Had Boeing any good will toward the debentureholders, it would surely have awaited the deposit of those coupons.

ARGUMENT

POINT I

BOEING HAS BEEN IN DEFAULT UNDER THE
CONVERSION RATE PROVISIONS FROM MARCH 31,
1960 TO DATE

A. The Several Breaches

Boeing committed a breach under Section 4.05 of the Indenture when it failed to adjust the conversion rate; and under Section 4.07 a) by failing to give notice to the Trustee of the change in the conversion rate, b) by failing to publish notice of that change and c) by failing to set aside and reserve the necessary additional shares.

Boeing failed to comply with the notice requirement of Section 5.02 in that, among other things, it failed to set forth the correct conversion rate in its notice of call.

B. Breach of Section 4.05(b)(v)

The breach which is absolutely incontestable is that with respect to the option shares.

Section 4.05(b)(v) reads:

"In case the Company shall at any time after July 1, 1958 ... issue or grant any options or rights to subscribe for capital stock ... the shares of capital stock issuable on ... the exercise of any such options ... (A) if inclusion thereof would result in a conversion rate greater than if excluded, shall be deemed ... for the purpose of computation made pursuant to subparagraph (a) of this Section 4.05, to have been issued at the time of the issuance or grant of such ... options ... The Company for the purpose of any computation under this subsection (v) shall be deemed to have received a consideration for such Capital Stock equal to the consideration received by the Company for the ... options ... so issued or granted, plus the consideration, if any, to be received by the Company upon ... the exercise of any such options ..."

The total option price of \$644,514 averages \$27.10 a share. These options apparently varied at Vertol for Vertol shares from \$14.589 to \$21.77 (A.E. 26, 1958 Financial Statement, p. 6) which would mean from \$21.88 to \$32.66 a share of Boeing. This corresponds exactly with Boeing's Stock Record (Tr. Exh. 6, App. 837a) which shows a low of \$21.88 for 834 shares in the third quarter of 1962 and a high of \$32.66 for 26 shares in the second quarter of 1962.

Thus, individually and collectively "inclusion" of the option shares "would result in a conversion rate greater than if excluded" as would any share issued for less than \$50.

Boeing so recognized in A.E. 35 at p. 3 by including these option shares in the calculation pursuant to "Section 4.05(b)(v)".

For the convenience of the Court we repeat A.S. 81 showing that for calculation purposes Boeing "valued" the option shares at 33.625, not at 27.10:

"81. If called at trial, H.W. Haynes would testify that:

The figure of \$15,250,000, plus the amount to be received upon the exercise of the Vertol stock options, was calculated as follows:

The November 13, 1959 closing price on the NYSE of \$33-5/8 for Boeing Capital Stock was multiplied by 472,736 shares 1448,954 shares being the shares issued in connection with the acquisition of the assets of Vertol and 23,782 shares being the shares which would be issued to Vertol employees in connection with the stock options granted to them by Vertol prior to the acquisition] giving a product of \$15,895,748. From this figure there was subtracted \$644,514, which was the amount Boeing would receive upon the exercise of the Vertol stock options, and this leaves an amount of \$15,251,234, which was rounded off to \$15,250,000."

Thus, Boeing attributed to the option shares \$799,669.75 rather than \$644,514 and the difference of \$155,155.75 is just plain padding.

This is the computation which the Board approved (Tr. p. 57, App. 370a).

If we deduct \$155,155.75 from Boeing's calculations and accept every other of its doings, correct ones and incorrect ones, we have a total consideration of \$388,104,106.25 for 7,939,209 shares, giving a conversion rate of 2.0456 requiring an additional 1/20 of a share.

C. The November 13, 1959 Date

Section 4.05(b)(ii) authorizes the directors to "determine" the "fair value" of the "consideration received" (A.E. 4, p. 35).

We suggest that the normal date on which to value what one "receives" is the date on which one receives it.

An appraisal would be made as of that date. Earnings and losses would be computed to that date. Book value would be on that date. Boeing did not enter the book value on November 13, 1959 for pooling purposes. Vertol lost \$988,636 before tax credit and \$476,770 after tax credit between January 1, 1960 and March 31, 1960 (A.E. 26, sixth page). What it may have lost between November 13 and December 31, 1959 we do not know. But we do know that its net worth declined between September 30, 1959 and March 31, 1960 by \$1,363,862 (A.E. 25 and 26). Did Boeing "receive" the lost million?

But for conversion rate purposes only Boeing purported to measure the "consideration received" on March 31, 1960 by the price of its stock on November 13, 1959. The difference was \$9.625 a share (before the addition of the excess from the option shares).

Mr. Pivar testified that the informal decision to make a counter-offer "would not have any significance to me, or at least, not enough significance to warrant the use of the price on that date for valuation of the shares issued" (p. 34 above).

And even so, the record shows that there was no firm decision to make the counter-offer as late as November 16 (A.E. 22, p. 7).

The contract is dated "as of January 18, 1960" (A.E. 24, pp. 1, 15), which was "the date the directors formally authorized the execution of the Plan and Agreement" (A.E. 25, p. 7). That contract, however, left many matters open: it was subject to approval by Vertol stockholders at "a meeting to be called and held on or prior

to February 24, 1960" (A.E. 24, p. 5) and if a certain number of Vertol holders dissented the contract was off (id., p. 12); the contract was subject to approval by the United States Government of the assignment of government contracts and by others (presumably lenders) to the transfer of Vertol property (id. p. 5); and it was subject to a host of "Obligations Prior to Closing" (id. pp 5-7) and of "Conditions Precedent" (id. pp 9-12). These open matters only strengthen our view that there was not such a firmly fixed obligation as of January 18 as to by-pass the normal procedure of valuing the receipt when received.

Lewis v. Realty Equities Corp., 373 F.S. 829
(S.D.N.Y., 1974) to be discussed below.

There is support in law for valuing what one pays or receives as of the day the obligation becomes "fixed" or the party becomes "irrevocably bound". Thus, under Section 16(b) of the Exchange Act that date has been taken for the purpose of fixing the date of the purchase and consequently as the date for valuation.

Blau v. Ogsbury, 210 F. 2d 426, 427
(C.A. 2, 1954)

Lewis v. Realty Equities Corp., 373 F.S.
829 (S.D.N.Y., 1974)

Allis-Chalmers Mfg. Co. v. Gulf & Western
Industries, 372 F.S. 570 (N.D. Ill., 1974)

So, too, income is taxable when the party has an unconditional right to receive it.

C.I.R. v. Ogsbury's Estate, 258 F. 2d 294
(C.A. 2, 1958)

Stoner v. United States, 313 F.S. 1383, 1388
(N.D. Ill., 1970)

As Judge Clark stated in Blau v. Mission Corp., 212 F. 2d 77, 80 (C.A. 2, 1954) these are persuasive analogies.

In a Section 16(b) case, Judge Carter recently held (Lewis, above, 373 F.S. 829, 831) that where there was no proof that "Conditions precedent" similar to some of the lesser ones in this case had been performed before the closing, he would take the closing date as the one on which obligations became fixed. There is no proof here as to when the Government consented to the assignment or the lienors to the transfer of the property or when Vertol's stockholders approved or when accountants' and attorneys' opinions were rendered. Thus, while we agree with Judge Ryan that January 18 is more rational, we submit that March 31st is most rational.

On the issue of liability it is not important whether the valuation is as of January 18 when the stock closed at 30 5/8 or as of March 31 when the stock was 24. The difference affects only a relatively small part of the damages.

To be realistic, Boeing selected November 13 because it presented the best price available to it. That the Court could "not say" that Boeing "had no colorable right" to select November 13 is not an acceptable test of whether one party entrusted with the duty of fairness to the other party has made a binding determination.

D. The Stock Dividends

It is obvious that a corporation receives no consideration when it pays a stock dividend. 11 Fletcher Cyclopedia of Corporations (Perm. Ed., 1971) 745. The indenture, however, creates a fictitious "consideration received" by Boeing in return for paying a limited stock dividend.

As we showed above (pp. 9-12) Boeing first computed the conversion rate correctly at 2.00 and later abandoned it when Vertol required adjustment (pp. 18-19 above).

Judge Ryan accepted Boeing's argument that it made a mistake in 1958. He said at p. 25 (App. p. 307a):

"The Indenture was drawn by Boeing; how to define market value was its decision to make out of several alternatives. Boeing had a right to so define it, and, having done so, it had not only the right but the duty to comply with the definition set forth in the Indenture, irrespective of the motive."

We respectfully submit that Judge Ryan's point of departure was incorrect. We should not assume that Boeing chose an unfair meaning when it drafted the indenture. It must be assumed that the object was to "determine" the "fair value" of the shares "so issued". The whole structure of Section 4.05(b) shows that. Where shares were to be issued for dollars or shares were to be optioned for dollar amounts, the consideration was to be valued at the dollars received or to be received. Where shares were to be issued for other than dollars the directors were to determine the "fair value" not an unfair value. Boeing wrote to the stockholders (Exh. 1 hereto annexed) what the "fair value" of the stock dividend shares was and the Directors adopted resolutions as to what "the fair value" was (pp. 11-12 above). That was 54.75, not 56.875. Was the intent that the stock dividend be priced at a price above its "fair value"?

No combination of the words of Section 4.05(b)(iv) and of Section 1.01 lead to an intent to make the market price on the date of declaration the value. That could have been said easily if

intended. No help was needed to "determine" the closing price — it was in the newspapers. Combining Sections 4.05 and 1.01 the reading must be "determine ... the consideration ... [for the- shares so issued... by the market value thereof ... on the date of declaration."

Of course, if there was ambiguity in the contract, that ambiguity must be resolved against Boeing, the draftsman.

4 Williston on Contracts (3rd ed. 1961) Section 621

We cannot conceive of better proof that there was ambiguity than Boeing's own two different versions.

Again, if Boeing, in 1958, before it knew that it would have a problem keeping the conversion rate down construed the clause as we have, it must have a very clear case to justify reversal of that original position. Williston, op. cit., Section 623 at p. 791 writes:

"In innumerable cases, and for reasons so varied as to defy classification, litigants at some later date often seek to place an interpretation on their agreements at variance with that indicated by their earlier conduct, utterances or performance... But whatever the nature of the case, the court will apply the canon of contemporaneous and subsequent construction unless this is contrary to the plain meaning of the contract."

Third, in a contract of adhesion such as this (Point III D. below) the contract not only is to be construed "most strictly against its author", but also the provision must be "fair, just, legal and reasonable". Williston, op. cit., Section 621, pp. 772- 773.

How fair, just or reasonable is it to value a dividend share at the same price as a pre-dividend share? If Boeing's position were correct, the dividend share would have the same value if the stock dividend were 1%, 2%, 3% or 4%. On its theory, increasing

the number of shares would not decrease the value of each share.

Certainly the stock market does not take that view. This very case proves the point. On November 4, 1958 Boeing declared 25¢ in cash and 4% in stock. The stock went ex both dividends on November 14. On November 13 Boeing closed at 54 1/8; on November 14 at 51 1/4; the difference is 2 7/8. The Wall Street Journal and the New York Times on November 15 reported the change as "minus 1/2", not minus 2 7/8. The reason is clear. The stock dividend at 4% represented a reduction in value of 2 1/8 and the 25¢ cash dividend of 1/4. This total of 2 3/8 meant that the decline in the stock was accounted for 2 3/8 by the dividends and 1/2 by market decline. (Tr. pp. 266-7, App. pp. 582a-583a).

E. Results in Dollars and in Conversion
Rate of Each Boeing Maneuver

A summary of the results of Boeing's maneuvers (see pages 18-19 and 30 and tables following page 35 above) is:

(a) The November 13, 1959 Date
as Against March 31, 1960

<u>Item</u>	<u>Increase In Consideration Received</u>	<u>Reduction In Conversion Rate</u>
Stock Dividends	\$2,023,410	.0109
Vertol Assets	4,321,072	.0232
Vertol Options	<u>155,155</u>	<u>.0008</u>
	\$6,499,637	.0349

(b) The November 13, 1959 Date
as Against January 18, 1960

<u>Item</u>	<u>Increase In Consideration Received</u>	<u>Reduction In Conversion Rate</u>
Stock Dividends	\$2,023,410	.0109
Vertol Assets	1,246,862	.0072
Vertol Options	<u>155,155</u>	<u>.0008</u>
	\$3,425,427	.0189

On Boeing's own computations the result of all the above was to reach a figure of 2.0048. Thus, if any one of the above items was not correctly calculated by Boeing, it is perfectly obvious that an adjustment of the conversion rate was required. The other figures would only change the amount of the adjustment.

POINT II

THE COURT BELOW ERRED ON THE FACTS IN FINDING THAT
BOEING ACTED IN "GOOD FAITH" AND ERRED ON THE LAW
IN CONCLUDING THAT "GOOD FAITH" EXCUSES A BREACH OF
CONTRACT

A. "Good Faith" As A Fact

With respect to the November 13, 1959 date, Judge Ryan wrote (App. p. 311a):

"The decision was carefully taken, not only with the approval of its accountants but of independent auditors, outside counsel, its investment bankers and underwriters, with the unanimous resolution of its Board and in good faith."

By "independent auditors" Judge Ryan intended Touche, Ross, Boeing's long-time accountants (App. p. 620a); by "outside counsel" he intended the Holman firm, Boeing's long-time attorneys (App. p. 499a); by "its investment bankers" he intended Harriman, Ripley, who managed

Boeing's issues at least between 1958 and 1966. (App. p. 561a).

We consider separately Mr. Haynes' "good faith" and the Board's "good faith". So far as appears the Board did not see the letters on which Mr. Haynes relied. Mr. Haynes simply told the Board that he had letters from the bankers who found valuation on November 13, 1959 to be "fair and reasonable" and from the attorneys who said that valuation based on the November 13, 1959 price "probably could not be challenged successfully" (A.E. 25, p. 8).

The attorneys' letter, dated April 4, 1960, the day of the meeting is very carefully drawn (A.E. 31). The writer wishes to be sure that he is referring only to the asset shares and not the option shares. It begins:

"You have requested our opinion concerning the determination to be made by the Board of Directors of the 'fair value' of the consideration received by Boeing for the 448,954 shares of Boeing stock issued in connection with the acquisition of substantially all of the assets and business of Vertol Aircraft Corporation."

The writer "understands" that Mr. Haynes is going to give the Board "the results" of the December, 1958 insurance company appraisal of "insurable values". Mr. Haynes did not anywhere give that "result"; instead he told the Board that there had been an appraisal which, adjusted by him to the present would, in his opinion, bring a current figure of \$17,350,000. He did not say that "insurable values" had decreased by \$4,900,000 in the fifteen months since the unspecified 1958 "result" was given to Vertol (See p. 26 above). The writer "understands" that he was going to give current book value, past earnings, and projected future earnings. He did none of these accurately and some not at all (see pp. 23-4 above). Finally, the closest the letter comes to approval of the

November 13, 1959 date is:

"if the Directors consider all relevant data concerning Vertol ... and after such consideration the Board concludes that a determination of the 'fair value' based on the method recommended by you is fair and reasonable, a court would be very unlikely to overturn the Directors' determination."

This is hardly an opinion defending November 13.

The Touche, Ross letter is somewhat stronger on the asset shares. (A.E. 30, p. 2). It gives four methods of valuation: 1) appraisal; 2) book value; 3) capitalization of earnings; 4) Boeing's stock prices. As we have shown, Boeing rejected the first three. On stock prices, Touche, Ross said:

"Because of the fluctuations in the market price of the company's stock between the date negotiations were authorized by the Board of Directors and the closing date, we believe the market value of the company's stock on the date negotiations were authorized is more indicative of what the Board of Directors believed to be the 'fair value' of the assets and business acquired from Vertol."

By fluctuation, Touche, Ross meant that the stock had gone from 33.625 to 24.

We point again to Touche, Ross' care in distinguishing the asset shares from the option shares. In the first sentence of the letter it makes clear the distinction. On p. 2, within ten lines, it makes clear four separate times that it is speaking of shares issued for the "'fair value' of the assets and business."

The Harriman, Ripley letter (A.E. 29) is puzzling. It is dated March 31, 1959 five days before the attorneys' and accountants' letters. The writer justifies November 13 for valuing the assets because he claims that New York Stock Exchange

Rules provide for valuing stock dividends on the date of declaration rather than the date of payment. We believe there is no such rule and our disbelief is shared at the Exchange. Rule 118 requires specialists to mark down their books on the ex-dividend date. Rule 325 requires uncollected stock dividends to be valued on the date of the financial statement and not on the declaration date. Section A13 of the Company Manual requires corporations to transfer from surplus to capital "the current share market price adjusted to reflect issuance of the additional shares." We believe that there are no other applicable rules. But to compare a declaration of a dividend to what the writer of the letter describes as an "actual decision to commence negotiations" (A.E. 29, bottom p. 1) four and one-half months before seems to us ludicrous.

But even more extraordinary is his support of the November 13 date for the stock options. He makes no reference to Section 4.05(b)(v). He relies on this "logic": 1) on November 13 no proposal existed as to the stock options; 2) "The basis ... was arrived at later in the negotiations"; 3) but "it is obvious" that Boeing "had to be prepared to give options"; 4) options meant shares; 5) therefore, "it seems appropriate" to value the option shares with the asset shares.

It will be noted that there is not one word in the letter as to what the Indenture says about the stock options. Without the circumlocutory "logic", he simply says the option shares should be valued with the asset shares.

We must presume that Mr. Haynes solicited these opinions—they did not come spontaneously. Did Mr. Haynes put credence in

the Harriman, Ripley opinion? Did he fail to get the others to support him on the options? We believe the letters support a finding of "bad faith" by Mr. Haynes.

The Board itself seems to us to have been in less than good faith. Its interests were adverse to those of the debenture-holders. It had been warned by its Vice-President-Finance that the acquisition "will increase" the conversion rate. One director asked what the breaking point was; the Board heard the answer \$15,216,000; was it innocent in fixing \$15,250,000? Mr. Allen testified that the Board was aware of the conversion rate issue (App. 382a). The acquisition went on Boeing's books at nearly \$3,000,000 less than \$15,250,000. The Boeing stock given was worth \$4,500,000 less than \$15,250,000 on the date it was given. Seven of the thirteen members of the Board were in management and the internal memoranda of management showed in connection with redemption of the debentures that the "basic objective" of management was to avoid dilution. We suggest that a finding of good faith in fact cannot be supported on this record.

B. The Significance of "Good Faith"
In Breach of Contract

Judge Ryan considered the matter of "good faith" only in connection with selection of the November 13 date.

He did not consider violation of Section 4.05(b)(v) the option clause at all. Obviously a breach of that clause would be a breach whether committed in good faith or in bad faith. Similarly, if our construction and Boeing's original construction of the dividend clause is correct, Boeing's violation of it, even if in

good faith, would be no less a breach.

All agree that a valuation of Vertol could not stand unless in "good faith".

We submit that even if the Board was innocent and was misled by a Boeing officer, Mr. Haynes, the determination of the Boeing Board was not in good faith. Boeing and its Board cannot be compartmentalized. If Mr. Haynes had innocently misled the Board by giving it the wrong price of the stock the mistake of Mr. Haynes would surely have been ground for overturning the decision. If he misled the Board, we suggest that personal integrity of the Board would not make its decision in good faith.

But here we have additional considerations. Probably not one debentureholder knew that there was an indenture provision giving the Board power to value an acquisition; nothing of the sort appeared in the prospectus which assured the purchaser of protection against dilution. No holder could have believed that directors with a conflict of interests would make such a determination.

Under such circumstances, can a choice by a Board among several methods of valuations stand when it picks a less rational date for which a Court cannot say there is no colorable basis? We submit that the selection of a less rational date when two more rational dates exist is not the kind of good faith which allows one party to a contract to make a binding determination for the other.

We quoted above from Williston that a contract of adhesion must be fair, just, legal and reasonable. To take a less rational valuation when more rational ones exist hardly meets the test.

Mr. Olsen's letter of advice (A.E. 31, p. 2) well says:

"This conflict of interests dictates that care be taken to insure that if the Directors' valuation of the assets should ever be challenged, their careful and thorough analysis of the matter and their good faith in the determination could be convincingly demonstrated."

Judge Ryan cites two cases in support of his "good faith" position (App. p. 311a).

In Morris v. Standard Gas & Electric Co., 31 Del. Ch. 20, 63 A. 2d 577 (1949) the application was to the Vice-Chancellor for a preliminary injunction against payment of a dividend on two classes of prior preferred stock. The applicant, owner of 100 shares of a third preferred, claimed that the dividends were being paid out of capital. The Board there did precisely what should have been done here. It hired admittedly independent appraisers who made a thorough study and concluded that the dividend would be paid out of surplus. Plaintiff claimed no fraud, no bad faith and no conflict of interest; only that in plaintiff's opinion there was no surplus. The Board went farther than the appraisal - it submitted the appraisal and its own opinion to the Securities Exchange Commission for approval under the Public Utilities Holding Act. The S.E.C. entered an order in which it refused to interfere with the dividend declaration. A statement that the holding was "under similar conditions" is unsupportable. On the contrary, the case shows what should have been done here.

Industrial & General Trust Ltd. v. Tod, 180 N.Y. 215 (1904), in our opinion, is squarely contrary to Judge Ryan's proposition. Bondholders deposited their bonds with a committee which was to draw a reorganization plan on condition that within thirty days

after notice of the plan, they might withdraw their bonds. No notice was given and the plan was nevertheless put into effect by the Committee. The holders were held entitled to damages. Judge Vann wrote at p. 225:

"The defendants, with all their power, could not make a new contract, or subvert the agreement by construing a vital provision into it or out of it (Citation). No one can be made, by contract, the final judge of his own acts, for the law writes 'good faith' into such agreements."

POINT III

BOEING COULD NOT TERMINATE THE CONVERSION OPTION WHILE BOEING WAS IN BREACH OF THE CONVERSION PROVISIONS

A. The Breach Was Material

The price of Boeing stock was \$158.25 on March 3, 1966; it was \$158.125 on March 29, 1966; and at some time in the preceding year it was \$175 (A.E. 46, A.S. 148).

At \$158 a share, each \$1000 debenture which was worth \$3160 at the conversion rate of 2 for 1, was worth \$3239 at 2.05 for 1 and \$3286.40 at 2.08 for 1.

At simply 2.05 the difference of \$7.90 on each \$100 face of debenture was nearly twice as much as the interest of \$4.50 per annum.

Collectively, the \$21,514,700 of debentures outstanding on March 8, 1966, the first day of the call, were worth \$2,719,458 more at 2.08 than at 2.00 (A.S. 152).

There can be no doubt that many people could have sold at higher prices and many would have converted long before the call

for redemption - perhaps at the time the stock was at \$175 - if they and prospective buyers had known that each \$100 was entitled to 2.05 or 2.08 shares rather than 2.00. The breach was, therefore, highly material both in influencing action by the holders in the market and in subjecting holders, who might otherwise have sold or converted, to the penalties of not seeing the advertisement.

B. The Effect of the Material Breach

"Solely for the purposes of discussion" Judge Ryan "assumed" that wrongful failure to adjust the rate would "void the call" (App. p. 304a).

The Restatement of Contracts, Sec. 269 reads:

"Where by the terms of promises for an agreed exchange a stated material performance by one party is due at an earlier time than a stated performance by the other party, the duty to render the later performance is constructively conditional on the earlier performance being rendered except as stated in Section 268(2)."

This is adopted verbatim in 6 Williston on Contracts, 3rd Ed. (1962) 77.

In the same volume, Williston says at page 6:

"And just as a failure to give a promise on one side would entail invalidity of the counter-promise, so a failure to give performance on one side should on this view deprive the party in default of a right to enforce performance on the other side since the court in general must assume the respective performances were regarded by the parties as equivalent in value."

The premises here were in fact conditions precedent as well.

5 Williston on Contracts, 3rd ed., (1961) 126 reads:

"A condition precedent is a fact or event which the parties intend must exist or take place before there is a right to performance. A condition is distinguished from a promise in that it creates no right or duty in and of itself but is merely a limiting or modifying factor. If the condition is not fulfilled, the right to enforce the contract does not come into existence."

In Mueller v. Howard Aircraft Corporation, 329 Ill. App. 570, 70 NE 2d 203 (1946) referring to the call of convertible debentures, Sullivan, P.J. wrote (at p. 207):

"Plaintiff's option to convert his debenture into common stock of the defendant corporation represented a substantial right, as did defendant's option to redeem said debenture. Therefore, in order for defendant to deprive plaintiff of his right to convert defendant was required to exercise its option to redeem in strict conformity with the redemption provisions of the debenture contract. This it did not do."

To effect a proper conversion both sides had to know the proper rate. Whether or not to exercise the conversion privilege depended very much on Boeing's promise to adjust the rate and to announce the increase in the rate. To terminate the right it had to publish the correct rate. The breach of the very provision which Boeing claims it has terminated only makes clearer the dependency of the right to terminate on Boeing's performance of its promise.

Purchasers pay a premium for the conversion privilege. The Accounting Principles Board of the American Institute of Certified Public Accountants, Inc. in APB Opinion No. 10 (December, 1966) states:

"8. A portion of the proceeds received for bonds or other debt obligations which are convertible into stock, or which are issued with warrants to purchase stock, is ordinarily attributable to the conversion privilege or to the warrants, a factor that is usually reflected in the interest rate".

Therefore, the opinion continues, the price paid for the privilege which

"may ordinarily be measured as the difference between the price at which the debt was issued and the estimated price for which it would have been issued in the absence of the conversion figure"

should be accounted for separately from the debt cost.

The present bond issue attests to both of the foregoing propositions. First, simultaneously with the raising of \$30,597,600 through the debentures at 4 1/2%, Boeing raised \$40,000,000 in non-convertible debt at 5% (A.E. 15, page 1). Second, "Most holders [of the 5% issue] are insurance companies and other large institutional investors (fewer distress sales)" [than the convertibles held by individuals] (A.E. 32 Ford memorandum, page 3).

It is the individual who is less apt to see the financial news and who usually suffers. 54 Cornell L.R. 271 "Convertible Securities: Holder who Fails to Convert Before Expiration of the Conversion Period".

In the early part of this century there were cases of bonds which contained no provisions as to the manner in which they could be called. Several courts held that only personal communication satisfied the requirement of notice.

Berkey v. Pueblo County, 48 Colo. 104,
110 P. 197 (1910)

Hinds County v. National Life Ins. Co.
104 Miss. 104, 61 So. 164 (1913)

Other courts held that the best practicable notice should be given. This is consistent with the due process and Rule 23 cases.

A convertible bond issued in 1958 and sold to stockholders all over the United States should have had a clause providing for better notice. Whatever means may have been available to locate holders in 1900, by 1958 in the light of the manner in which coupons were deposited and the way in which records should have been kept pursuant to the Trust Indenture Act, Boeing's limitation of the notice to two printings in any New York paper was not a reasonable clause.

We submit that aside from the rules relating to contracts of adhesion, this is an unconscionable clause and, in 1958, anyone reading the clause would have recognized it as such. The small stockholder who bought these bonds (App. p. 3a) was probably no reader of the Wall Street Journal. More than \$9,000,000 of the \$19,970,300 redeemed came in after the advertisement in the New York Times (App. 298a). We do not attribute all of this to the Times but the coincidence is impressive and emphasizes how unjust the clause is.

The Uniform Commercial Code was not enacted in New York until 1962 but the principle that a contract or a clause in a contract

which was unconscionable at the time it was made may be refused enforcement had been accepted in the United States Courts both before and after that date, particularly in cases of contracts of adhesion.

Campbell Soup Company v. Wentz, 172 F. 2d 80
(CA 3, 1948)

Shay v. Agricultural etc. Committee, 299 F. 2d
516 (CA 9, 1962)

Osborn v. Boeing Airplane Company, 309 F. 2d 99
(CA 9, 1962)

Williams v. Walker and Thomas Furniture Co.
350 F. 2d 445 (CA DC, 1965)

American Service etc. Company v. Bottum
371 F. 2d 6 (CA 8 1967)

Barrette v. Home Lines Inc., 168 F. Supp. 141
(SDNY, 1958)

C. The Option to Register

The option to register is no answer to the failure to give reasonable notice. We pointed out at pp. 5-6 above that neither the two letters sent to stockholders nor the prospectus informed the holder that the bonds might be registered (A.E.s 5, 15); that 11 of the bonds were issued as coupon bonds (A.S. 48); and that only the fine print in the debenture gave the holder notice that he had the right to return his debenture in exchange for a registered one. At least 93% of the holders did not register (A.S. 57, 58).

As we shall show in the next section, in the absence of clear notification to the holder of his rights, he cannot be charged with failing to exercise them.

D. The Debenture Was a Contract of Adhesion

A contract of adhesion, said the Court of Appeals of the Ninth Circuit, is "one which gave the plaintiffs but one choice - to adhere to it or reject it."

Osborn v. Boeing Airplane Company
309 F. 2d 99, 103 (C.A. 9, 1962)

Since the early days of printed form contracts there has been a growing recognition of the fact that rules of interpretation governing negotiated contracts must be modified in the case where the acceptor takes the printed contract as it is or rejects it.

Professor Edwin W. Patterson of Columbia Law School in "The Interpretation and Construction of Contracts", 64 Columbia Law Review 833, 856 (1964) attributes the term "contract of adhesion" to the French jurist Raymond Saleilles who in 1901 wrote as follows:

"There are pretended contracts that have only the name, the juridical construction of which remains yet to be made. For these, in any event, the rules of individual interpretation should undergo important modifications, if only that one might call them, for lack of a better term, contracts of adhesion, those in which a single will is exclusively predominant, acting as a unilateral will which dictates its law, no longer to an individual, but to indeterminate collectivity and which in advance undertakes unilaterally, subject to the adhesion of those who would wish to accept the law of the contract and take advantage of the engagements imposed on themselves."

4 Williston on Contracts (3rd ed., 1961) in the Supplement to Sec. 626, note 11, after referring to the above quotation states that the term "contract of adhesion ... is gradually finding its way into judicial opinions", citing federal and state cases.

The Williston footnote continues:

"In adhesion contracts (insurance policy) courts will ascertain that meaning of the contract which the weaker contracting party (the insured) would reasonably expect. Gray v. Zurich Ins. Co. 54 Cal. 2d 104, 219 P. 2d 168." (Underscoring ours).

Restatement of Contracts Second (not yet official) uses the term "Standardized Contracts" in Section 237 and is fully in accord with the foregoing.

The matter of what the acceptor may "reasonably expect" goes beyond the matter of interpretation. It includes rights which are squarely contradicted by the words of the document.

In Osborn v. Boeing Airplane Company, 309 F. 2d 99 (C.A. 9, 1962) Boeing had an employee suggestion plan. The printed form on which the employee entered his idea stated that "the decision of the Company shall be final and conclusive as to the person entitled to a cash award and the amount of such award." The District Court felt that was the end of the matter. The Ninth Court of Appeals said "a possible interpretation" was "that Boeing was not to have unfettered discretion" noting (p. 103):

"See also Shay v. Agricultural Stabilization Comm., 299 F. 2d 516, 517 (9th Cir., 1962), and authorities cited regarding the construction of a "'contract of adhesion' - one which gave the plaintiffs but one choice - to adhere to it or reject it."

The Court concluded, at p. 102, that despite the clear words of Boeing that it was the final judge, it could not say that "there was indeed no expectation of payment." The reasonable expectation thus negated the clear words.

In New York, it was held that the purchaser of a flight insurance policy which provided in the clearest words that it did not cover charter flights, was entitled to expect coverage where the vending machine stood near the charter flight counter.

Lachs v. Fidelity & Casualty Co., 306 N.Y.
357 (1954)

The Court said that the contract

"must be read through the eyes of the average man on the street or the average housewife who purchased it." (p. 364).

The Supreme Court of California has held that a policy clearly excluding coverage on a charter flight was nevertheless binding on the company where the charter flight was taken because a regular flight was unavailable.

Steven v. Fidelity & Casualty Co., 58 Cal. 2d
862, 377 P. 2d 284 (1962)

The Court wrote at p. 293:

"As we shall explain in more detail the cases have held that in such contracts the expected coverage of the policy could only be defeated by a provision or limitation which has been plainly brought to the attention of the insured". (Underscoring ours).

In this case, as we have shown, the right to register was not brought to the attention of the holder; nor was the right to terminate his conversion privilege by publishing in any English language paper published in Manhattan. The latter appeared only in the indenture. The holder's "reasonable expectations" required better notice than that.

The doctrine of contracts of adhesion is not limited to insurance policies, shipping contracts, etc. It has been applied to suggestion contests, to automobile purchase contracts, to

government agricultural plans, to sales of a tomato crop and to filling station operation.

Henningsen v. Bloomfield Motors, Inc.
32 N.J. 358, 161 A. 2d 69 (1960)

Shay v. Agricultural etc. Committee
299 F. 2d 516 (C.A. 9, 1962)

Campbell Soup Company v. Wentz, 172
F. 2d 80 (C.A. 3, 1948)

Standard Oil Co. v. Perkins, 347 F. 2d
379 (C.A. 9, 1965)

E. Reasonable Expectations of Notice

The holder was entitled to expect notice which was reasonable under the circumstances.

What was reasonable for debentures worth 3 1/2 times the face amount might not be reasonable for debentures worth slightly more or even less than face. The holder was entitled to expect greater effort if failure of notice would cause him loss than if it would not.

There were, as we pointed out at pp. 38-42 above several simple, effective and inexpensive ways of notifying the holders. We repeat them briefly:

1. a letter to those who had deposited January 1, 1966 coupons;
2. waiting for the deposit of July 1 coupons;
3. a letter to stockholders;
4. a letter to those who exercised the warrants.

There was no hurry. It is stipulated (A.S. 100):

"No provision of the debentures or the indenture prevented any of the new financing contemplated in and prior to February, 1966 and all of the financing could have been accomplished without redeeming the debentures".

Boeing says that it wished to broaden the base for the purchase of its new stock and debentures. (The rights for the debentures were not issued until August 26, 1966, A.S. 149).

How much was the base broadened? There were 41,246 stockholders on March 7, 1966 and 42,758 on April 8, 1966 (A.S. 147). Meantime nearly \$20,000,000 worth of debentures had been converted. This attests to two things: 1) that the very great majority of the holders were stockholders since only 1512 stockholders were added and perhaps not by redemption only and 2) that "broadening the base" is a farcical explanation.

The "base was broadened" when the stock was split (A.S. 147). That usually broadens the base.

In July, 1958, Boeing set aside and reserved 611,952 shares for conversion (A.S. 27). 181,658 had been issued by March 8, 1966. 430,294 remained set aside. Those shares would and should have been retained for a reasonable time. Nothing less satisfied the "reasonable expectations" of holders that they would be dealt with fairly and honestly.

F. Notice by Publication Is the Least Satisfactory Form of Notice

The courts have long since recognized that the poorest attempt at notice is notice by publication.

The Supreme Court of the United States wrote in Mullane v. Central Hanover etc. Co., 339 U.S. 306, 315, 94 L. ed. 865 (1950):

"It would be idle to pretend that publication alone as prescribed here, is a reliable means of acquainting interested parties of the fact that their rights are before the courts. It is not an accident that the greater number of cases reaching this Court on the question of adequacy of notice have been concerned with actions founded on process constructively served through local newspapers. Chance alone brings to the attention of even a local resident an advertisement in small type inserted in the back pages of a newspaper, and if he makes his home outside the area of the newspaper's normal circulation the odds that the information will never reach him are large indeed. The chance of actual notice is further reduced when as here the notice required does not even name those whose attention it is supposed to attract, and does not inform acquaintances who might call it to attention. In weighing its sufficiency on the basis of equivalence with actual notice we are unable to regard this as more than a feint."

1 Weinstein-Korn-Miller "New York Civil Practice", par. 315.01

reads:

"Publication is not a means well calculated to give actual notice to the party served. CPLR 315 was therefore designed to discourage service by publication except where other methods of service are impracticable."

Acc. Walker v. Hutchinson, 352 U.S. 112,
1 L. ed. 2d 178 (1956)

New York v. New York etc. Railroad Co.
344 U.S. 293, 97 L. ed 333 (1953)

In Eisen v. Carlisle & Jacquelin, 391 F. 2d 555, 569

(C.A. 2, 1968) Judge Medina wrote:

"On the record before us we cannot arrive at any rational and satisfactory conclusion on the propriety of resorting to some form of publication as a means of giving the necessary notice to all members of the class on behalf of whom the action is stated to be commenced and maintained. But we assume that some sort of ritualistic notice in small print on the back pages of a newspaper would in no event suffice."

If such "ritualistic notice in small print on the back pages of a newspaper" would not satisfy Rule 23(c) there is every reason to hold that it does not satisfy the requirement of fairness which

should govern every contract and it does not satisfy the reasonable expectations of a party to a contract of adhesion.

POINT IV

BOEING VIOLATED SEC. 10(b) OF THE EXCHANGE ACT AS WELL AS THE TRUST INDENTURE ACT

A. Section 10(b) and the Conversion Rate

In Affiliated Ute Citizens, etc. v. United States et al, 406 U.S. 128, 31 L. ed. 2d 741 (1972) employees of a transfer agent who had knowledge of the market and who received collateral benefits when sales were made, were charged with failure to disclose to sellers of stock "material facts that reasonably could have been expected to influence their decisions to sell." (p. 153) The Court held that such failure to disclose violated Section 10(b).

In Shapiro v. Merrill Lynch et al, 495 F. 2d 228, 240 (C.A. 2, 1974) this Court followed that holding and quoted from the Supreme Court in the Ute case:

"Under the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision ... This obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact." (Emphasis supplied by this Court.)

This court held it unnecessary for plaintiffs to prove that they would have taken different action if they had received the material information.

So, here, no one can say that plaintiffs would not have converted or sold their bonds at the pre-call high had they known the facts or that they would not have converted sooner. The

stock had been 175 1/4 within a short time before the call (A.E. 46) and each \$1000 bond would have been entitled to 21 shares. The value would have been \$3680 rather than \$3,505.

The failure to disclose (more precisely the concealment of) the adjusted conversion rate, we respectfully submit, created a liability under Section 10(b).

B. Section 10(b) and the Failure to Give Notice

The S.E.C. has, we believe, correctly construed Section 10(b) to mean that when securities are "publicly traded by the use of any means or instrumentality of interstate commerce or of the mails or of any facility of any national securities exchange" failure to give notice may be a manipulative or deceptive device (e.g. Rule 10(b)(17)).

In Karl E. Sommerlatte, CCH Federal Securities Law Reporter, '71-'72, ¶78,557, (October 8, 1971) the security-holder asked three questions: 1) has the S.E.C. any rules requiring notice to holders of registered bonds or convertible debentures when their securities are called for redemption by the corporation? 2) if the answer is affirmative, does publication satisfy or must there be notice by mail? and 3) is a brokerage firm which holds such securities required to give timely notification to the customer?

The S.E.C. considered the question important enough to depart from its practice of not answering "hypothetical questions." The answer omitted the word "registered" and mentioned only "bonds or convertible debentures". It said that such notices are covered in regulations only by Rule 10b-17 and under Section 14 of the Act and then stated:

"However, depending on the facts and circumstances, the anti-fraud provisions of the federal securities laws may be applicable."

The S.E.C. obviously had in mind unregistered bonds since indentures for registered bonds require notice by mail. Which "facts and circumstances" then could be more manipulative than those where the corporation fails to use coupon lists, stockholders' lists or purchase warrant lists?

C. The Trust Indenture Act

The 1939 Act, 53 Stat. 1150 U.S.C.A. 77bbb declares that the national public interest and the interest of investors in debentures are adversely affected.

"(4) When the obligor is not obligated to furnish to the Trustee under the indenture and to such investors adequate current information as to its financial condition, and as to the performance of its obligations with respect to the securities outstanding under such indenture; or when the communication of such information as to the names and addresses of such investors generally is not available to the trustee and to such investors." (Underscoring ours)

and it further provides:

"And it is declared to be the policy of this sub-chapter, in accordance with which policy all the provisions of this sub-chapter shall be interpreted to meet the problems and eliminate the practices, enumerated in this section connected with such public offerings."

The section then provides in subdivision (b):

"Practices of the character above enumerated have existed to such an extent that, unless regulated, the public offering of notes, bonds, debentures, evidences of indebtedness, and certificates of interest or participation therein, by the use of means and instruments of transportation and communication in interstate commerce and of the mails, is injurious

to the capital markets, to investors and to the general public; and it is hereby declared to be the policy of this subchapter, in accordance with which policy all the provisions of this subchapter shall be interpreted, to meet the problems and eliminate the practices, enumerated in this section, connected with such public offerings."

The indenture here provides in Section 8.01 (A.E. 4, page 58):

"that the company covenanted that it would furnish to the trustee all information in its possession or in the possession of its paying agents semi-annually:

"as to the names and addresses of the holders of debentures obtained since the date as of which the next previous list, if any, was furnished."

It is stipulated that no such list was ever furnished by Boeing to Chase and apparently no such list was ever compiled by Chase as paying agent (A.S. 54).

Had Boeing provided Chase with this information it could easily have given the notice which the holder was reasonably entitled to expect.

It may be that since Chase was paying agent as well as Trustee that it had, from the coupon deposits, enough information from which to compile its own list. Boeing is just as liable as if the list had been kept and disregarded but the simple fact is that the Trust Indenture Act was cavalierly disregarded.

POINT V

BY MISSTATING THE CONVERSION RATE THE CALL DID NOT CONFORM TO THE INDENTURE

Section 5.02 (A.E. 4, p. 42) requires the notice of call to state "the conversion rate at the time applicable." The notice gave the conversion rate as 2 shares for each \$100 rather than

2.08 (A.E. 46).

The difference, as of March 8, 1966, was approximately \$2,750,000. We recognize a) that the error did not cause the failure to see the advertisement and b) that had the advertisement been seen the conversion would have occurred at 2 shares for each \$100, but we suggest that, as in foreclosure cases, a notice which is materially in error is a nullity.

POINT VI

THE HOLDERS ARE ENTITLED TO DAMAGES
FOR THE VALUE OF ALL OF THE SHARES
THEY WOULD HAVE RECEIVED HAD THE
DEBENTURES BEEN PROPERLY CALLED

It is stipulated that all tenders made after March 29, 1966 were refused and that after that date all tenders would have been refused "regardless of whether or not such debentures were in fact tendered after that date" (A.S. 164).

As of March 29 Boeing was in actual breach of the covenant to adjust and publish the conversion rate and in anticipatory breach of its covenant to issue shares in conversion since tender had not yet been made.

In view of the various dates on and after March 30, 1966 on which tenders were presumably made, the date of repudiation, March 30, 1966, appears to be the logical date to be taken for the breach. The New York rule is that damages for non-delivery of securities of a fluctuating value are measured by the highest price of the security within a reasonable time after the delivery date. On April 14, 1966 Boeing shares traded at \$182 (A.S. 148)

At the conversion rate of 2.08 and the share price of 182, the holders were entitled to receive \$378.56 for each \$100 of debenture. The total for the holders of \$1,544,300 was \$5,846,102.08.

Those who did later redeem are entitled to the difference between what they received and \$378.56 for each \$100. They received no consideration for surrendering their bonds. They were admittedly entitled at least to what they were given (A.S. 165).

We believe that those who converted between March 8, 1966 and April 8, 1966 are also members of the class. Those people were deceived when they saw the notice which the other members of the class did not see. The former were entitled to .08 of a share more than they received. They, the holders of \$19,970,300 of debentures (A.S. 152) were entitled to receive an additional \$14.56 for each \$100 of face value of debentures.

Boeing urges that those who did convert are not members of the plaintiff class. We admit that we did not plead for them originally but since their rights under the conversion rate cause of action are completely parallel to those of nonconverting plaintiffs, we believe that they too should recover here; and if necessary the pleadings should be conformed to the proof.

Cf. Miller v. Alexander Grant & Co., CCH Fed. Securities Rep. '71-'72 993287, (Dooling, J. E.D.N.Y., 1971)

Cf. DeMilia v. Cybernetics International Corp., CCH Fed. Securities Rep. '71-'72 993386 (Gagliardi J., S.D.N.Y. 1972)

CONCLUSION

By manipulation of the conversion calculations Boeing caused some debentureholders to sell or to convert at inadequate prices; and caused others who might have sold or converted to hold their debentures. Until this breach is remedied, Boeing has and had no right to call the debentures.

By failing to make an effort to locate all holders through any of several readily available ways, - i.e. by failure to exercise reasonable diligence to give notice and by failing to withhold the cutoff for a reasonable period which would allow the unknowing to receive notice, Boeing exhibited a complete lack of regard for the holders. The holders were reasonably entitled to expect a sincere effort to reach them.

Plaintiffs are entitled to receive the fair value of the investment which they made.

Plaintiffs ask for judgment as follows: that on surrendering their debentures, those who have not redeemed shall receive the sum of \$378.56 for each \$100 of debenture; that those who redeemed after March 29, 1966 receive the sum of \$275.31 for each \$100 of debenture which they surrendered; and that those who did convert in time after the call receive an additional \$14.56 for each \$100 face of debenture. The total in the first two classes is \$5,846,102.08 and in the third class \$2,907,675.68 plus interest.

Respectfully submitted,

NATHAN, MANNHEIMER, ASCHE, WINER & FRIEDMAN
Attorneys for plaintiffs

NORMAN WINER
Of Counsel

BOEING AIRPLANE COMPANY
SEATTLE 24, WASHINGTON

December 17, 1958

To the Stockholders:

On November 3, 1958, the Board of Directors declared a 4% stock dividend on the outstanding shares of the capital stock of the Company payable December 17, 1958 to stockholders of record at the close of business on November 19, 1958, at the rate of one share for each 25 shares held on the record date. The Board of Directors also declared a quarterly cash dividend of 25¢ per share payable on December 10, 1958 to stockholders of record at the close of business on November 19, 1958. This cash dividend was not paid on the additional stock being issued in payment of the 4% stock dividend. Checks in payment of the cash dividend were mailed under separate cover.

The resolution declaring this 4% stock dividend provides that no fractions of one share shall be issued in connection with the payment of the dividend but that such fractions of one share shall be aggregated and a certificate for such aggregate number of shares issued to City Bank Farmers Trust Company, or its nominee, as agent for the holders of shares of capital stock entitled to such fractions, and the fractions of one share so aggregated sold by such agent, acting on behalf of and for the convenience of the holders of capital stock entitled to such fractions of one share, and the net proceeds distributed to the holders of capital stock entitled thereto.

If at the close of business on November 19, 1958, you were the holder of not less than 25 shares of capital stock of the Company, you will find enclosed one or more certificates representing the number of full shares of capital stock to which you are entitled by reason of this stock dividend.

If you were entitled to a fraction of one share of capital stock (whether or not you were entitled to one or more full shares), you will find enclosed a check issued by City Bank Farmers Trust Company payable to your order representing the proportionate amount of the price of one full share of capital stock, as sold by City Bank Farmers Trust Company or its nominee, which corresponds to the fraction of one share to which you were entitled. Such stock was sold by the Bank at an average net price of \$49.3204 per share.

Receipt by a holder of capital stock of this stock dividend does not increase his proportionate equity in the Company. However, the sale of any part of his stock dividend will reduce such proportionate equity.

Upon payment of the stock dividend there will be transferred from the retained earnings account to the capital stock account the sum of \$54.75 for each full share issued, or a total of \$15,414,151. This represents the approximate fair value of the stock to be issued in payment of the dividend determined by reference to the approximate market value of such shares on the New York Stock Exchange at the close of business on such Exchange on November 3, 1958, adjusted to give effect to the additional shares of capital stock to be outstanding upon the payment of said dividend. The net earnings (unaudited) of the Company for the nine months ended September 30, 1958, are \$27,328,805. Cash dividends paid and payable during the year 1958 amount to \$7,016,726. The purpose of the stock dividend is to pay to the stockholders a dividend in stock in lieu of higher cash dividends, thereby conserving funds to finance work in progress and additions to the Company plant and equipment.

There is set forth on the reverse side of this letter certain information concerning the treatment of the stock dividend for federal income tax purposes and certain information concerning cash dividends paid by the Company during the year 1958, and the treatment for federal income tax purposes of rights issued by the Company in July 1958 to subscribe to the Company's 4½% Convertible Subordinated Debentures due July 1, 1980.

Very truly yours,

J. E. PRINCE
Secretary
Boeing Airplane Company

FEDERAL INCOME TAX INFORMATION

Relating to Dividends Declared and Subscription Rights Issued
during the year 1958 by

BOEING AIRPLANE COMPANY

Dividends were declared and paid by the Company during the year 1958 as follows:

<u>Payment Date</u>	<u>Record Date</u>	<u>Payment per Share</u>
March 10	February 21	\$0.25
June 10	May 20	0.25
September 10	August 20	0.25
December 10	November 19	0.25
December 17	November 19	4% stock dividend

In addition, on July 15, 1958, the Company offered to stockholders of record on that date rights to subscribe to its 4½% Convertible Subordinated Debentures due July 1, 1960, at the rate of \$100 principal amount of debentures for each 23 shares of capital stock of the Company held on such date.

Counsel for the Company have advised that in their opinion the stock dividend and the rights to subscribe to debentures distributed by the Company during 1958 are subject to the following federal income tax treatment in the hands of stockholders under the present provisions of the Internal Revenue Code.

4% Stock Dividend:

Receipt of one or more full shares of capital stock in payment of the stock dividend does not constitute receipt of taxable income. The basis of the newly acquired stock is determined by apportioning your cost or other basis of the stock with respect to which the dividend was received between that stock and the newly received stock in accordance with the ratio that the number of shares of each bears to the total number of shares of both the old and the new. If the number of old shares was evenly divisible by 25, the ratio would be 3.85% to the new and 96.15% to the old. Your holding period for the newly acquired stock is the same as that for the stock with respect to which the dividend was distributed.

The Company has been advised that to the extent you receive a check as a result of the sale on your behalf of any fraction of one share to which you were entitled as a result of the declaration of this dividend, the Internal Revenue Service has determined that such payment is to be treated as a cash dividend taxable to the recipient as ordinary income. Under such determination the receipt of such check will not, however, require any adjustment of the cost or other basis of this capital stock.

Rights to Acquire 4½% Convertible Subordinated Debentures:

Receipt of these rights did not constitute receipt of taxable income. Moreover, neither the exercise of these rights by the purchase of debentures nor the conversion of the debentures into capital stock constitutes a taxable transaction. If you allowed the rights to lapse, no loss arises for tax purposes.

Unless you expressly elect otherwise, the rights have no basis (cost) for federal income tax purposes, and all of the proceeds from a sale of the rights would be treated as a capital gain. However, if you make an express election in your 1958 return, you may apportion your basis of the stock with respect to which the rights were issued between that stock and the rights in proportion to their respective fair market values on the date of distribution. The required allocation has been determined by the Company to be approximately 99.12% to the old stock and approximately 0.88% to the rights. Your holding period with respect to the rights includes the period during which you held the stock with respect to which the rights were issued. However, your holding period with respect to debentures acquired upon exercise of the rights, and also with respect to capital stock acquired through conversion, commences on the date the rights are exercised.

If you desire more detailed information regarding these matters, it is suggested that you consult with your tax adviser.

APB Opinion No. 10

OMNIBUS OPINION—1966

DECEMBER, 1966

Consolidated Financial Statements
 Poolings of Interest—Restatement of Financial Statements
 Tax Allocation Accounts—Discounting
 Offsetting Securities Against Taxes Payable
 Convertible Debt and Debt Issued with Stock Warrants
 Liquidation Preference of Preferred Stock
 Installment Method of Accounting

INTRODUCTION

1. This is the first of a series of Opinions which the Board expects to issue periodically containing:

(a) Amendments of prior Opinions of the Accounting Principles Board and Accounting Research Bulletins of its predecessor, the committee on accounting procedure, as appear necessary to clarify their meaning or to describe their applicability under changed conditions.

(b) Affirmation of accounting principles and methods which have become generally accepted through practice and which the Board believes to be sound, and when it desires to prevent the possible development of less desirable alternatives.

(c) Conclusions as to appropriate accounting principles and methods on subjects not dealt with in previous pronouncements and for which a separate Opinion is not believed to be warranted.

CONSOLIDATED FINANCIAL STATEMENTS

(Amendment to Accounting Research Bulletin No. 51)

2. Paragraph 1 of ARB No. 51 states that "There is a presumption that consolidated statements . . . are usually necessary for a fair presentation when one of the companies in the group directly or indirectly has a controlling financial interest in the other companies." The usefulness of consolidated financial statements has been amply demonstrated by the widespread acceptance of this form of financial reporting. A research study on the broader subject of accounting for intercorporate investments is now in process which will encompass the matters

¹ This paragraph modifies paragraphs 19 and 20 of ARB 51 insofar as they relate to domestic subsidiaries. An accounting research study on the subject of foreign investments and operations is in process. The Board has deferred consideration of the treatment of foreign subsidiaries in consolidated financial statements until the study is published. In the meantime, the provisions of Chapter 12 of ARB 43 (as amended by paragraph 18 of APB Opinion No. 6 and by paragraphs 17, 21 and 22 of APB Opinion No. 9) continue in effect.

The Board has also deferred consideration of the treatment of jointly owned (50 per cent or

covered in ARB No. 51. Pending consideration of that study the Board has adopted the following amendments to ARB No. 51.

3. If, in consolidated financial statements, a domestic subsidiary is not consolidated,¹ the Board's opinion is that, unless circumstances are such as those referred to in paragraph 2 of ARB No. 51,² the investment in the subsidiary should be adjusted for the consolidated group's share of accumulated undistributed earnings and losses since acquisition.³ This practice is sometimes referred to as the "equity" method. In report-

less) companies pending completion of the study on accounting for intercorporate investments.

² "For example, a subsidiary should not be consolidated where control is likely to be temporary, or where it does not rest with the majority owners (as, for instance, where the subsidiary is in legal reorganization or in bankruptcy)."

³ Cumulative undistributed earnings at the effective date of this Opinion should be reflected, with a corresponding adjustment of retained earnings, and reported as a prior period adjustment resulting from a retroactive change in the application of an accounting principle; where

APB Accounting Principles

Opinion No. 10

1. It is a general principle of accounting that the offsetting of assets and liabilities in the balance sheet is improper except where a right of setoff exists. Accordingly, the offset of cash or other assets against the tax liability or other amounts owing to governmental bodies is not acceptable except in the circumstances described in paragraph J below.
2. Most securities now issued by governments are not by their terms designed specifically for the payment of taxes and, accordingly, should not be deducted from taxes payable on the balance sheet.
3. The only exception to this general principle occurs when it is clear that a purchase of securities (acceptable for the payment of taxes) is in substance an advance payment of taxes that will be payable in the relatively near future, so that in the special circumstances the purchase is tantamount to the prepayment of taxes. This occurs at times, for example, as an accommodation to a local government and in some instances when governments issue securities that are specifically designated as being acceptable for the payment of taxes of those governments.

CONVERTIBLE DEBT AND DEBT ISSUED WITH STOCK WARRANTS

8. A portion of the proceeds received for bonds or other debt obligations which are convertible into stock, or which are issued with warrants to purchase stock, is ordinarily attributable to the conversion privilege or to the warrants, a factor that is usually reflected in the stated interest rate. In substance, the acquirer of the debt obligation receives a "call" on the stock. Accordingly, the portion of the proceeds attributable to the conversion feature or the warrants should be accounted for as paid-in capital (typically by a credit to capital surplus); however, as the liability under the debt obligation is not reduced by such attribution, the corresponding charge should be to debt discount. The discount so recognized (or the reduced premium if the proceeds exceed the face amount of the debt obligation) should thereafter be accounted

for in accordance with Chapter 15 of ARB No. 43 as amended by paragraph 19 of APB Opinion No. 6 and by paragraph 17 of APB Opinion No. 9. Upon conversion, the related unamortized debt discount should be accounted for as a reduction of the consideration for the securities being issued.

9. The discount or reduced premium, in the case of convertible debt obligations, may ordinarily be measured as the difference between the price at which the debt was issued and the estimated price for which it would have been issued in the absence of the conversion feature. Warrants are frequently traded and their fair value can usually be determined by market prices at the time the debt is issued; accordingly, proceeds of the issue can be allocated in proportion to the relative market values of the debt obligations and warrants.

LIQUIDATION PREFERENCE OF PREFERRED STOCK

10. Companies at times issue preferred (or other senior) stock which has a preference in involuntary liquidation considerably in excess of the par or stated value of the shares. The relationship between this preference in liquidation and the par or stated value of the shares may be of major significance to the users of the financial statements of those companies and the Board believes it highly desirable that it be prominently disclosed. Accordingly, the Board recommends that, in these cases, the liquidation preference of the stock be disclosed in the equity section of the balance sheet in the aggregate, either parenthetically or

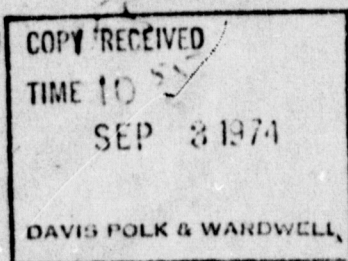
"in short," rather than on a per share basis or by disclosure in notes.

11. In addition, the financial statements should disclose, either on the face of the balance sheet or in notes pertaining thereto:

- a. the aggregate or per share amounts at which preferred shares may be called or are subject to redemption through sinking fund operations or otherwise;
- b. as called for by paragraph 35 of APB Opinion No. 9, the aggregate and per share amounts of arrearages in cumulative preferred dividends.

services of two copies of
the within is
hereby admitted this day
of 197

Attorney for



THE END

